U.S. Department of Transportation

Entrepreneurial Services Program Financing Handbook

June 1993

FEDERAL TRANSIT ADMINISTRATION

Entrepreneurial Services Program Financing Handbook

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FEDERAL TRANSIT ADMINISTRATION ENTREPRENEURIAL SERVICES PROGRAM

Financing Handbook

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Scott M. Reznick, President
Commonwealth Development Associates

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INTRODUCTION

Profit-making opportunities exist for new, small businesses founded by community and business groups, professional providers and transportation management associations in niche transportation markets.

Inadequate financing during the start-up and expansion phases of business development is an obstacle that niche service providers, like small businesspeople in all industries, must overcome to assure profitability.

To access private and government-supported financing, niche company entrepreneurs must be familiar with the financial analysis and planning techniques for evaluating investment opportunities and monitoring a company's financial health, as well as with the sources, terms and conditions of available financing.

Effective financial analysis, planning and strategies are essential to the success of niche transportation companies.

The Federal Transit Administration (FTA) has commissioned Commonwealth Development Associates to prepare a *Financing Handbook* to help companies in its Entrepreneurial Services Program (ESP) obtain financing adequate to their needs. ESP provides niche companies with planning and capital investment dollars and technical assistance to foster the development of financially self-sufficient, market-responsive transportation services.

FTA's objectives for the *ESP Financing Handbook* are to:

> Describe basic financial analysis and planning, and the types of private and government-supported financing available for small, niche transportation companies.
>
> Develop model financial statements and strategies that will illustrate niche company operations and financial support during their start-up and expansion phases of development.

To meet these objectives, Commonwealth Development Associates has written the *Handbook* to help niche transportation company entrepreneurs, including Resident Management Corporations and other community-based businesspeople, identify available private and government-supported financial resources, and develop the information and effective strategies needed to use them.

The *Handbook* is organized into four chapters. Chapter One describes the basic methods of financial analysis. In Chapter Two, financial planning techniques are outlined. The different sources of funding including equity (or stock ownership) investment, short- and long-term loans are described in Chapter Three. Chapter Four provides four different models of reverse commuting companies, showing how these companies can be financed at start-up and through their stages of growth. A Glossary of Financial Terms is provided for novice entrepreneurs.

Each section in each chapter of the *Handbook* begins with a list of essential business questions the entrepreneur will be able to answer using the financial methods described in the section. These questions are designed to help niche company owners and managers with limited business experience use the *Handbook* and develop the kinds of information, plans and financial strategies they need to successfully finance their companies.

Chapter One describes how to read financial statements such as balance sheets, income statements and statements of cash flow; how to use ratio analysis to track niche company performance and obtain financing; and how to use breakeven analysis to determine the best price for transportation services and the minimum number of rides that must be provided to achieve profitability. These methods of financial analysis will help niche company entrepreneurs set up and analyze the financial health of their companies on an ongoing basis in the same way good owners, managers, lenders and investors analyze small businesses.

Chapter Two helps entrepreneurs develop financial plans for their small transportation businesses. It describes the types of information that banks and other sources of funding, including ESP, will want to know before they will award your company a loan. A financial plan enables a company to control expenses, identify financing needs and effectively apply for financing. Chapter Two outlines the methods used to develop financial projections and calculate their short-term cash flow and long-term financing requirements. Techniques for evaluating the financing of vehicles are also identified. The Chapter concludes by describing solutions to cash flow shortages, the most common financial problem for new, expanding businesses.

In Chapter Three, the *Handbook* describes how to find equity and debt, or borrowed, capital. It introduces niche company entrepreneurs to the various sources of available financing and the major terms and conditions of financial agreements. The different types of business structures, including corporations, partnerships, associations, for-profit and non-profit entities, and basic accounting considerations are then described. The Chapter continues by identifying the uses, sources and agreement terms and conditions of private equity investments, short- and long-term financing. It describes the various sources of Federal, state and local government financing for small businesses, including FTA grants, SBA loans and loan guarantees and HUD loans. The Chapter concludes by outlining success and failure factors in applying for financing.

Chapter Four provides financial analysis, projections and strategies for four model reverse commuting companies. Reverse commuting companies provide job training and placement and transportation back and forth to the job site, frequently a suburban location that is inaccessible at a reasonable cost and commuting time by public transportation.

The first reverse commuting model involves only minimum initial capital investment. The business is established as a non-profit, community owned and operated corporation that provides job training and placement services, but subcontracts transportation services to a private provider. Its start-up financing needs include working capital for office rental and equipment, salaries and marketing expenses. Its financing sources include owners' equity, government and foundation grants, and trade credit (suppliers willing to accept delayed payment for their goods or services).

The business grows through model stages II and III by directly providing transportation services with leased and then purchased vehicles. Vehicle maintenance is contracted out. As the company grows, its needs for capital also grow.

Finally, at model stage IV, the company requires maximum capitalization. It owns and operates its vehicles and provides for their maintenance. Its financing needs include the capital to buy its vehicles and facilities as well as working capital to cover office expenses, salaries, marketing, vehicle operating and maintenance costs. Its financing sources include owners' equity, government and foundation grants, seed capital, real estate loans, equipment loans, trade credit, line of credit, accounts receivable loans, public/private loans and loan guarantees.

The ESP *Financing Handbook* is an introduction to business finance for niche transportation companies. It will help entrepreneurs, including community-based businesspeople, gain knowledge of the language and techniques of finance that will give them greater credibility with investors and lenders.

The *Handbook* should, however, be a supplement to, and not a replacement for, professional assistance. Attorneys, accountants, loan officers and financial consultants are available to niche company entrepreneurs in the private sector and through government supported programs such as FTA's Public Private Transportation Network (PPTN) and SBA's Small Business Development Centers.

CHAPTER ONE

HOW TO ANALYZE YOUR COMPANY'S FINANCIAL CONDITION

I. INTRODUCTION TO FINANCIAL ANALYSIS

Business Questions for Section I

What is financial analysis?

How can financial analysis help you run your niche transportation company?

A. What is financial analysis?

1. Financial analysis lets the owners and managers of a company, and its lenders, know how well the company is being run.

2. Financial analysis is used to spot problems and develop effective solutions.

3. The basic tools of financial analysis include:

    a. Financial statements - balance sheets, income statements and statements of cash flows;

    b. Financial ratio analysis; and

    c. Breakeven analysis.

B. *Why financial analysis is important.*

1. All companies must regularly analyze their financial condition. Small companies, particularly, are vulnerable to start-up and expansion problems. For example, new, small businesses frequently face cash flow shortages, i.e., they run out of immediate cash, that can be anticipated through ongoing financial analysis.

2. New entrepreneurs may be unfamiliar with financial analysis. They make mistakes that could be avoided. For example, financial analysis can be used to identify a need for additional financing before that need reaches emergency proportions. It can also be used to help entrepreneurs realize that they have placed too large a debt burden on their company.

3. Financial analysis lets business owners and managers keep track of trends in the operation of their companies, and also to compare their own business performance with that of other similar companies in their industry. It will also help them detect problems in their business and overcome weaknesses.

4. Consultants can train entrepreneurs in financial analysis and help identify problems and their solutions. Learning financial analysis is essential to the economic health and stability of all businesses and, particularly new, small and expanding businesses.

II. READING FINANCIAL STATEMENTS

Business Questions for Section II

What is the basic information used in the financial analysis of your niche transportation company?

What can you tell about your company from its balance sheet, income statement and statement of cash flows?

What are your company's assets? liabilities? equity?

What are its current assets? fixed assets?

What are its current liabilities? long-term liabilities?

How can you determine your company's available working capital?

A. Financial Statements:

A company's financial statements are its balance sheets, income statements and statements of cash flows. They provide the basic information used in financial analysis. Financial statements are used by business owners and managers to keep track of their ongoing business performance. They are also used by investors and lenders such as banks to determine whether they will provide a company with financial support.

1. The balance sheet is a picture of a company's financial position at a given point in time.

2. An income statement describes where company revenues came from and expenditures went over a period of time.

3. The statement of cash flows describes how working capital is derived and used.

B. Balance Sheets:

1. A company's balance sheet follows a basic equation:

Assets = Liabilities + Equity

It balances what the business owns (its assets) with what it owes its creditors (its liabilities) plus its owners' investment (its equity capital).

2. A balance sheet represents the financial picture of the company on one particular day, ordinarily the last day of its fiscal year.

   a. It includes information for both the most recent year and previous year, to let owners, managers and lenders compare company performance from one year to another.

   b. The company's performance trends are established by reviewing its balance sheet over a period of 3-to-5 years.

3. Balance sheets are presented in two columns: Assets, and Liabilities plus Equity. Both columns are always in balance. They always equal each other.

4. **Assets**: This side of a balance sheet ordinarily includes current as well as fixed assets.

   a. **Current assets** include the company's cash plus items which will be converted into cash within a year. Small companies tend to have a higher percentage of their assets in current assets than in fixed assets. A niche transportation company's bank accounts, accounts receivable and inventory are its current assets.

   b. **Fixed assets** will be of value to the company for more than a year. They include land, buildings, vehicles and equipment.

   c. **Other assets** include the long-term portion of loans or notes receivable (the portion due more than twelve months from the balance sheet date) and rent or utilities deposits which have been paid and will be held for more than a year.

5. **Liabilities and Owners' or Stockholders' Equity**: The other side of the balance sheet includes:

   a. **Current liabilities** include accounts payable, payroll taxes payable, accrued expenses, taxes payable, and the current portion of loans and notes payable (the portion payable during the next twelve months).

   b. **Other liabilities** includes the long-term portion of loans and notes payable (the portion which is due more than twelve months from the balance sheet date).

   c. **Owners' equity:**

      i. The owners' original investment and any subsequent increases in that investment through the sale of new stock (common stock).

      ii. Increases in owners' or stockholders' investment over and above the price of the common stock (additional paid in capital).

iii. Profits or losses generated since the company's inception (retained earnings).

6. **Working capital**: The difference between current assets and current liabilities is called working capital.

   a. Current liabilities are debts due within one year, paid out of current assets.

   b. Working capital is the amount of cash or near-cash assets a company would have left over if all current debts were paid. Near-cash assets are items that may easily be sold and converted into cash.

   c. Small companies like niche transportation firms often face cash flow shortages in their working capital.

C. Income Statements:

1. A company's income, or **profit and loss**, statement explains how much money the company made or lost during the year.

2. Income statements follow this arithmetic:

Sales

minus

Cost of Goods Sold

equals

Gross Margin

minus

Administrative and Selling Expenses

equals

Operating Income

minus

Interest Expense

equals

Income before Taxes

minus

Federal, State and Local Taxes

equals

Net Profit

minus

Dividends

equals

Increase or Decrease in Net Worth or Shareholder's Equity

3. A small transportation company's income statement matches the amount of money received from selling services and other items of income against all the costs incurred to deliver those services.

4. The difference between income and costs is a company's **net profit** or **net loss** for the year, a company's "bottom line."

5. 3-to-5 year trend analysis of income statement information and, particularly net profit or loss trends, can be a practical guide to how the company may do in the future.

D. *Statement of Cash Flows:*

1. The Statement of Cash Flows focuses on the change during the period in cash and cash equivalents. For purposes of the statement, cash equivalents are short-term, highly liquid investments that have original maturities of three months or less (Treasury bills, commercial paper, money-market funds, etc.).

2. The Statement of Cash Flows helps a company manage its cash so that it is available to pay bills when they are due. It permits owners, managers and lenders to evaluate the company to determine if its cashflow is adequate to meet its financial needs.

3. The Financial Accounting Standards Board of the American Institutute of Certified Public Accountants, who sets standards for the accounting profession, recommends that the Statement of Cash Flows be presented using the "direct" method, discussed

below. There is also an "indirect" method of presentation which the Board considers acceptable and is used by many businesses and accountants.

4. The Statement of Cash Flows classifies cash receipts and cash payments according to whether they stem from operating, investing or financing activities.

5. The direct method of presentation of the Statement of Cash Flows is prepared as follows:

   a. **Cash Flows from Operating Expenses:**

      i. Cash receipts from customers (excludes interest and other income received from investments, payments received from loan repayments, and proceeds from the sale of fixed assets).

      ii. Cash disbursements for payroll and all other expenses (excludes payments for interest expense, corporate net income taxes, fixed assets, loan repayments).

      iii. Other income received (dividends and interest).

      iv. Interest paid.

      v. Corporate net income taxes paid.

      vi. The total of i. through vi. above is **"Net Cash Provided (Used) by Operating Activities."**

   b. **Cash Flows from Investing Activities:**

      i. Receipts from the sale of fixed assets.

      ii. Payments for purchase of fixed assets.

      iii. Receipts from payments on loans and notes receivable (excluding interest).

      iv. Disbursements on loans and notes receivable.

      v. Receipts from the sale or return of investments (excluding dividends and interest) whose original maturities exceeded three months.

      vi. Disbursements to acquire equity investments (common stock in other companies), or other investments whose original maturities exceed three months.

vii. The total of i. through vii. above is **"Net Cash Provided (Used) by Investing Activities."**

c. **Cash Flows from Financing Activities:**

i. Receipts from borrowings (loans and notes payable).

ii. Payments on loans and notes payable.

iii. Receipts from issuance of stock.

iv. Payments of dividends and other distributions to owners, and acquisition of treasury stock.

v. The total of i. through iv. above is **"Net Cash Provided (Used) by Financing Activities."**

d. The net total of the three categories of cash receipts and disbursements (operating, investing and financing) is the **Net Increase or Decrease in Cash and Cash Equivalents**. When this sum is added to the total of **Cash and Cash Equivalents** at the beginning of the period, it equals the total of **Cash and Cash Equivalents** at the end of the period (the first line in current assets on the balance sheet) .

6. Supplemental to the Statement of Cash Flows, the **Reconciliation of Net Income to Net Cash Provided by Operating Activities** must be provided. This shows the difference between accrual and cash based profit or loss during the period.

a. The **Net Income** from the income statement for the period is given first.

b. Then **Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities** are listed, derived in this way:

i. Add back depreciation and amortization expense because they are non-cash expenses.

ii. Subtract any income statement gain (or add loss) on sale of fixed assets or investments.

iii. Add or (subtract) the decrease or (increase) in accounts receivable during the period.

iv. Add or (subtract) the decrease or (increase) in other current assets (excluding loans or notes receivable) appearing on the balance sheet (the other current assets can be listed individually if that level of detail is desired).

v. Add or (subtract) the decrease or (increase) in other assets (excluding fixed assets) appearing on the balance sheet.

vi. Add or (subtract) the increase or (decrease) in accounts payable during the period.

vii. Add or (subtract) the increase or (decrease) in other current liabilities appearing on the balance sheet (excluding loans or notes payable).

viii. Add or (subtract) the increase or (decrease) in other liabilities (excluding loans or notes payable) appearing on the balance sheet.

ix. The total of lines i. through viii. are **Total Adjustments**.

x. The net of the Total Adjustments and Net Income is **Net Cash Provided by Operating Activities**, which equals the number appearing on the main page of the Statement of Cash Flows with the same heading.

7. The indirect method of preparing the Statement of Cash Flows substitutes the Reconciliation of Net Income to Net Cash Provided by Operating Activities for the method used in 6.i. for showing Cash Flows from Operating Activities, and is therefore shorter and easier to prepare, although the direct method provides more information and is easier to understand.

E. Good Bookkeeping

Balance sheets, income statements and statements of cash flows are only as valuable to business owners and managers, investors and lenders as the accuracy and completeness of the information they contain. It is essential, therefore, that an entrepreneur establish a good bookkeeping system when he or she starts the company to provide the information needed for good financial statements.

III. USING RATIO ANALYSIS TO TRACK COMPANY PERFORMANCE AND OBTAIN FINANCING

Business Questions for Section III

What is financial ratio analysis?

How is ratio analysis used as a basic business decision-making tool by owners, managers, investors and lenders?

How can you use ratio analysis to compare your niche company with other similar transportation companies?

How can you use ratio analysis to compare your company's current performance with its past performance?

What will liquidity ratios tell you about your company's cash flow?

How will debt or leverage ratios help you to understand your company's creditworthiness?

What will your company's debt or cash flow coverage ratio reveal about its ability to borrow money?

What will activity ratios tell you about how effectively your company is using its resources?

How will profitability ratios help you understand how successfully you are running your business?

A. *Ratio Analysis:*

Ratio analysis uses the information contained in balance sheets, income statements and statements of cashflows to make basic financial and business decisions. It enables a company, its owners and lenders to:

1. Evaluate the performance, profitability, and financial condition of the company;

2. Spot positive and negative trends in the operation of the business;

3. Analyze and control working capital;

4. Compare the company with other, similar companies in the industry;

5. Compare company financial performance with past performance, and analyze its future financial trends;

6. Evaluate the safety of owners' and lenders' investments.

B. Using Ratio Analysis:

1. **Comparison with other, similar companies**: Ratio analysis may be used to compare a niche transportation company with other, similar companies in the transportation industry. The Standard Industrial Classification, or SIC, Code best approximating niche transportation companies is 4111.

   a. Financial ratios may be different for different size companies.

      i. Gross sales is often used as a means of determining a company's size.

      ii. The average ratios identified in this *Handbook* were all based upon 1989 Dunn & Bradstreet data for 352 companies with annual gross sales of approximately $1,750,000.

   b. When using ratio analysis, significant variation from industry norms should be examined in detail to determine their cause.

      i. How significant are the variations?

      ii. What do they imply for the company's future performance or financial condition?

      iii. What type of action by the company is needed to correct them?

   c. Potential creditors and investors use ratio analysis to determine a company's **creditworthiness.** Loan agreements often specify the ratio levels that a company must maintain.

2. **Comparison with past performance**: Ratio analysis is used to compare current company performance with its performance in earlier periods.

   a. Financial ratios should be calculated periodically, at least monthly and annually.

   b. By comparing your company's current financial ratios with ratios for the preceding month and year, you can better understand where your business stands and identify any trends in its performance. Ratio analysis is the early warning system that will permit you to anticipate upcoming business problems and opportunities.

c. Some trends may reflect normal, seasonal variations. Others may indicate a long-run change in performance or financial condition.

C. The Five Types of Financial Ratios:

For small transportation firms, there are five basic types of financial ratios:

1. **Liquidity Ratios** measure the capacity of a company to pay its bills and meet its short-term financial obligations.

2. **Debt or Leverage Ratios** measure the relative amounts of debt and equity in the financial structure of a company, and its capacity to meet its long-term obligations. They indicate creditworthiness.

3. **Coverage Ratios** describe the relationship between a company's interest payments and its capacity to pay them. They are also indicators of creditworthiness.

4. **Activity Ratios** measure how effectively a company uses its resources, such as accounts receivable.

5. **Profitability Ratios** measure the entrepreneur's success in operating the company.

D. Liquidity Ratios:

1. **Current Ratio**: current assets divided by current liabilities.

   a. For the niche transportation company, current assets include cash, accounts receivable and inventory. Current liabilities consist of accounts payable, short-term notes payable, current liabilities of long-term debt, and accrued taxes and expenses.

   b. **How to calculate the current ratio:**

$$\frac{\textbf{Current Assets}}{\textbf{Current liabilities}}$$

   c. **What the current ratio means to business management, owners and lenders:**

      i. The current ratio measures the short-term financial condition of a company. It describes a company's ability to pay its current bills with current cash.

      ii. The higher the current ratio, the greater the ability of a company to pay its bills.

iii. For small niche transportation companies with an SIC Code of 4111, the average current ratio is **1.59**.

a) A lower than average ratio can be a sign of financial risk and instability.

b) A ratio higher than average can indicate that current assets are not being used efficiently.

2. **Quick**, or **Acid-Test**, **Ratio**: current assets minus inventory divided by current liabilities.

a. Because small transportation companies do not ordinarily carry a substantial inventory, the quick ratio may be a better measure of their liquidity than the current ratio.

b. **How to calculate the quick ratio**:

<u>Current assets minus inventory</u>
Current liabilities

c. **What the quick ratio means to business management, owners and lenders**:

i. The quick ratio considers only current assets that can be easily converted into cash. Therefore, inventory is excluded from the quick ratio.

ii. The higher the quick ratio, the greater the ability of the company to pay its bills.

iii. A quick ratio of 1.0 means that one dollar of current assets, excluding inventory, is available to cover one dollar of current liabilities. For small transportation companies, the average quick ratio is **1.06**.

3. **Liquidity Ratio**: cash flow from operations divided by daily cash operating costs.

a. **Liquidity** is the ability of a company to convert assets into cash easily and without significant losses. High liquidity means that a company will be able to meet its debts promptly, earn trade discounts, benefit from a good credit rating and take advantage of market opportunities.

b. **How to calculate the liquidity ratio**:

<u>Cash flow from operations</u>
Daily cash operating costs

c. **What the liquidity ratio means to business management, owners and lenders:**

i. The liquidity ratio is a conservative measure of cash position. It indicates the number of days the company's cash would last without any additional cash intake.

ii. A higher liquidity ratio means a better cash position. Small transportation companies have an average liquidity ratio of approximately **0.11**.

E. Debt or Leverage Ratios:

1. **Debt-to-Assets Ratio**: total company liabilities divided by total company assets.

a. Total liabilities include current liabilities to be paid within one year and long term liabilities which will be paid over more than a year. Total assets include current assets and fixed assets.

b. **How to calculate the debt-to-assets ratio:**

$$\frac{\textbf{Total liabilities}}{\textbf{Total assets}}$$

c. **What the debt-to-assets ratio means to business management, owners and lenders:**

i. The debt-to-assets ratio states the relationship between debt invested by creditors and the assets of the company.

ii. The debt-to-assets ratio indicates company creditworthiness and, therefore, the financial risk associated with lending it money.

iii. The higher a debt-to-asset ratio becomes, the less likely it is that a company will be able to repay its loans. The company may be overextended in its borrowing.

iv. For small niche transportation companies, the average debt-to-assets ratio is **39.9%**.

v. A high debt-to-assets ratio means that it will be unlikely that a company will be able to borrow money. Future loans may need to be heavily secured and pay higher interest rates.

2. **Debt-to-Equity Ratio**: total company debt divided by total company equity or net worth.

a. For a small transportation company, total debt includes short- and long-term debt. Equity, or net worth, equals total assets minus total liabilities.

b. **How to calculate the debt-to-equity ratio**:

$$\frac{\textbf{Total debt}}{\textbf{Total assets minus total liabilities}}$$

c. **What the debt-to-equity ratio means to business management, owners and lenders**:

i. Debt-to-equity is an indicator of the creditworthiness of the company.

ii. The debt-to-equity ratio states the relationship between debt capital invested by creditors and equity capital invested by owners. A company is obligated to repay creditors. Equity capital provides a financial cushion and is used to pay off loans if company cash flow is insufficient.

iii. A lower debt-to-equity ratio means less risk of delinquency or default in the repayment of a loan. A higher ratio indicates greater risk.

iv. Stable cash flow permits creditors to accept a higher debt-to-equity ratio.

v. For small transportation companies, the average debt-to-equity ratio is **0.66**.

F. Coverage Ratios:

1. **Debt,** or **Cash Flow, Coverage Ratio**: cash flow minus interest and taxes divided by interest and principal payments on long-term debt.

a. When using the debt coverage ratio, cash flow is determined by adding depreciation back into income and then subtracting interest and taxes. Depreciation spreads the cost of certain assets, like vehicles, over their useful life.

b. For transportation companies that lease their vehicles, the debt coverage ratio is calculated by dividing cash flow minus interest and taxes by all fixed charges including lease payments.

c. **How to calculate the debt coverage ratio**:

$$\frac{\textbf{Cash flow plus depreciation minus interest and taxes}}{\textbf{Interest plus principal}}$$

d. **What the debt coverage ratio means to business management, owners and lenders:**

i. The debt coverage ratio indicates the ability of a company to make its payments on its long-term loans. It measures the amount of cash flow available to meet interest and principal, or debt service, payments.

ii. For small transportation companies, the average debt coverage ratio is **3.7**.

iii. A higher than average ratio identifies a company with additional borrowing capacity.

G. Activity Ratios:

1. **Net Working Capital Turnover Ratio**: sales revenues divided by net working capital.

a. Net working capital equals current assets minus current liabilities.

b. **How to calculate the net working capital turnover ratio:**

$$\frac{\textbf{Sales revenue}}{\textbf{Net working capital}}$$

c. **What the net working capital turnover ratio means to business management, owners and lenders:**

i. This ratio measures how effectively a company is using its working capital to generate sales. The higher the ratio the less working capital the company needs to operate.

ii. If a company's net working capital turnover ratio is lower than industry averages, the company may not be using its working capital efficiently. If far higher, the company may not have enough working capital to support its sales. New, small companies, including transportation companies, are often short of working capital.

iii. For small transportation companies, the average net working capital turnover ratio is **5.7**.

2. **Average Collection Period**: accounts receivable divided by annual credit sales as divided by 360.

a. Accounts receivable is the money owed to a company by its customers for delivered services. Annual credit sales are sales not immediately paid for by customers.

b. **How to calculate average collection period**:

$$\frac{\textbf{Accounts receivable}}{\textbf{Annual credit sales/360 days}}$$

c. **What the net working capital turnover ratio means to business management, owners and lenders**:

i. Average collection period tells the company if its customers are paying their bills on time.

a) It is a reflection of the company's credit policy, its diligence in collecting on its bills, and the attractiveness of any price discounts it offers for prompt payment.

b) A liberal company credit policy, involving relaxed credit standards to generate higher sales volume, will usually result in a longer average collection period.

ii. If a company's average collection period is lower than industry averages, the company may wish to liberalize its credit policies to increase sales. If higher, the company may not have a sound, competitive credit policy.

iii. For small transportation companies, the average collection period is **55 days**.

H. Profitability Ratios:

1. **Net Profit Margin**: net income after taxes divided by annual sales.

a. Net income equals the dollars remaining after all company expenses have been paid. It is the difference between total sales and total expenses.

i. Net income after taxes is the company's "bottom line," or the amount of money kept by the company to pay future expenses (retained earnings) or paid to equity owners as a return on their investment (dividends).

ii. Net income is the same as net earnings, net profit (or loss).

b. **How to calculate net profit margin**:

$$\frac{\textbf{Net income after taxes}}{\textbf{Annual sales}}$$

c. **What net profit margin means to business management, owners and lenders**:

i. Net profit margin is a basic measure of a company's profitability. It is an indicator of operating efficiency and pricing policies.

ii. A negative net profit margin means that a small transportation company is losing money on each ride it provides. The company should either cut costs or raise prices. Failure to do so may lead to bankruptcy.

iii. If a company's net profit margin is lower than industry averages, it indicates that sales are low relative to expenses, prices are too low, expenses are too high, or some combination of these factors.

iv. For small transportation companies, the average net profit margin is **-0.07**.

v. Similar comparisons should be made with the company's net profit margin during earlier years of business to determine if it is continuing to operate efficiently and to properly price its services.

2. **Return on Investment (ROI)**: net profits after taxes divided by total assets.

a. A company's return on investment, or ROI, is a basic measure of its success in efficiently using its assets to generate retained earnings or dividends.

b. **How to calculate return on investment**:

$$\frac{\textbf{Net income after taxes}}{\textbf{Total assets}}$$

c. **What return on investment means to business management, owners and lenders**:

i. ROI measures how effectively a company's assets are being used to create profits. The higher a company's return on investment, the more successfully it is utilizing its assets.

ii. A lower than average ROI means that the company is not earning an appropriate return for its owners. It indicates that the firm could be investing its resources more wisely.

iii. For small transportation companies, the average net profit margin is **-0.05**.

IV. BREAKEVEN ANALYSIS

Business Questions for Section IV

What is the minimum level of ridership your company must have to break even and achieve profitability?

What calculations will you use to determine your company's breakeven point?

How can you determine the price per ride that your company should charge?

A. Breakeven Analysis:

Breakeven analysis identifies a major benchmark in the early life of a company: the level of sales needed to pay its bills and achieve profitability.

B. Breakeven Point:

The breakeven point is that level of sales where total costs equal total revenues.

1. Above its breakeven point, a company makes money. The company is profitable. Additional sales volume should add to profitability.

2. Below its breakeven point, a company loses money. Companies that operate below their breakeven point run the risk of bankruptcy.

3. Breakeven analysis should be used for each route followed by a niche transportation company as well as total company costs and revenues.

C. How to calculate breakeven point:

$$\frac{\textbf{Fixed costs}}{\textbf{Revenue per unit minus variable costs per unit}}$$

1. **Fixed costs** are those costs which do not vary with the number of units, or rides delivered or vehicles used. Also called indirect costs, they typically include management salaries, rent, utilities, long-term debt service and business insurance.

2. **Variable costs** vary directly with the number of rides delivered or vehicles used. These direct costs typically include drivers' salaries, gas, vehicle insurance, and a percentage of administrative costs.

3. **Revenue** equals total income from sales.

D. *Using breakeven analysis:*

The use of this formula will enable owners, managers and lenders to determine the number of rides a company must sell at a given price per ride in order to reach profitability. Exercise caution when using breakeven analysis. Assumptions that costs are fixed or variable may oversimplify business realities. Fixed costs can and do vary. Salaries and rent, for example, can change. Variable costs may change more, or less, than anticipated. Changes in the price of service will also change the breakeven point.

E. *Pricing Decisions:*

Another way in which companies can understand breakeven is to evaluate the price they charge for each ride they deliver.

1. The **selling price per ride** should be equal to the total of fixed costs per ride, variable costs per ride and profit per ride.

2. **The formula for calculating selling price is**:

Variable costs per ride

plus

Fixed costs per ride

plus

Profit per ride

equals

Selling price per ride

3. When making pricing decisions, a company should be sensitive to changes in the demand for its services which may result from changes in price.

4. Sometimes, a price increase will cause so large a drop in the demand for services that profits will decrease instead of increase.

5. Sometimes, a drop in price will increase profits. This occurs when the lower price stimulates a very large increase in demand. Even though the price per ride is reduced, the number of rides delivered increases so substantially that profits go up. If the number of rides does not increase substantially, profits may fall.

CHAPTER TWO

HOW TO DEVELOP YOUR COMPANY'S FINANCIAL PLAN

I. INTRODUCTION TO FINANCIAL PLANNING

Business Questions for Section I

What is financial planning?

Why will financial planning be important to your company?

What are the basic components of the financial planning process for small transportation companies?

How can financial planning help you evaluate your company's performance?

A. What is financial planning?

1. Financial planning is a process for projecting the future performance and financial needs of a company.

2. It provides an objective method for both evaluating company performance and making financial decisions.

3. The financial planning process is used to determine if a proposed business or project can be successful.

4. It is also used to anticipate future events and develop company actions to effectively respond to them.

B. Why financial planning is important:

1. A financial plan sets out specific performance goals, or benchmarks, that enable owners and managers to monitor and control expenses and measure performance.

2. With a financial plan, a company can identify outside financing needs and effectively present requests for financing to outside financing sources. Your financial plan gives you the information you need to successfully develop and pursue a strategy to raise equity and debt capital for your niche company.

C. The Financial Planning Process:

1. Developing financial projections,

2. Determining short- and long-term financing needs,

3. Evaluating the financing of vehicles, and

4. Dealing with cash flow problems.

D. Comparing Actual Performance with Benchmarks:

Company success depends upon comparing its performance with its plan goals and benchmarks on a timely and accurate basis. Comparisons between actual performance and benchmarks should occur monthly, quarterly and annually. These comparisons will help the company identify problems and opportunities before it's too late.

II. DEVELOPING FINANCIAL PROJECTIONS

Business Questions for Section II

What are financial projections?

How can financial projections help you determine your company's future financial needs ?

How can they help you set benchmarks and measure your company's success in meeting them?

What are the steps in calculating financial projections?

A. Projected financial statements:

Projected balance sheets, income statements and statements of cash flow permit a company to determine its financing needs and measure how well it is meeting its goals and performance benchmarks.

B. Time frame:

Projections cover a stated period of time. The first year of projected income and cash flow statements should be calculated on a monthly basis, followed by annual totals for years two and three. Balance sheet projections may be calculated on an annual basis over a period of three years.

C. Base period and growth rate:

Projections are historical financial information and patterns adjusted to take into consideration anticipated future events. They begin from a base period and change as company sales increase (or decrease). Historical data is used to determine both a realistic base period and growth rate.

1. For an established business, its own historical data will be the best source of base period and growth rate information.

2. If the company is a start-up, financial projections will be based upon research by the entrepreneur of historical financial information from other companies in the business.

   a. This information may be available through trade associations or government agencies that provide managerial assistance to new businesses.

   b. The Models in Chapter Four of this *Handbook* were based upon historical financial information of successful niche transportation companies.

D. Future external factors:

Owners and managers should anticipate future conditions outside of their company that may impact upon base period calculations and, particularly, growth rates. Such factors may include:

1. National, regional and local economic trends, including: the business cycle (growth or recession); interest rates; consumer or business spending patterns; wage rates.

2. Regional and local transportation industry trends.

3. Population and other trends relevant to the company's customer base, locality and region.

E. Spreadsheets:

Use your base period and growth rate assumptions to project income statements, balance sheets and statements of cash flow. A good computer spreadsheet program can make this job a great deal easier.

F. "What If" Analysis:

Perform "what if" analysis on your projections to determine the impact of changes in external factors and company strategy on financial performance. Adjust your projections to reflect best case assumptions, worst case assumptions and most likely case assumptions.

III. DETERMINING FINANCING REQUIREMENTS

Business Questions for Section III

What are your company's short-term cash flow needs?

What are the steps in preparing a cash flow forecast?

What are your company's long-term financing requirements?

How can you predict your company's need for new vehicles?

A. Short-Term Cash Flow Needs:

1. To determine short-term financing needs, a company must first develop a one-year cash flow forecast.

   a. **Cash Flow Forecast:** To prepare a cash flow forecast, the company must distinguish between income and cash flow.

      i. Sales add to income; collections from customers add to cash flow.

      ii. Expenses subtract from income; payments to suppliers subtract from cash flow.

      iii. Capital expenditures, principal repayment on loans and dividends are cash flow expenditures, but not expenses for income statement purposes.

      iv. Depreciation is an expense item on an income statement, but not a cash outlay.

   b. **The steps for preparing a cash flow forecast:**

      i. Estimate total monthly receipts, including cash and credit sales, collections on credit sales and cash collected from other sources.

      ii. Estimate total monthly disbursements, including vehicle operating costs, payroll and benefits, other expenses such as rent, marketing and administrative costs, interest and principal payments on short-term and long-term debt.

iii. Determine the company's net cash inflow or outflow for the month by subtracting total receipts from total disbursements.

iv. Determine the company's beginning cash balance and ending cash balance by taking the ending cash balance from the previous month and adding net inflow or outflow from the current month.

v. Repeat the process for twelve months.

2. If the cash balance at the end of the month or year is negative or below a minimum level, the firm may have to borrow to make up the difference. If it is higher than the minimum amount, the company has surplus cash.

B. Long-Term Financing Requirements:

1. Long-term financing needs depend on the company's expected level of sales, or ridership. Expected sales are used to predict the number and type of new vehicles needed to service the expected riders (as well as any buildings or other facilities the company may require).

2. **Percentage of Expected Sales:** A percentage of expected sales technique is used to project the number of new vehicles required.

   a. The percentage of projected sales method is based on an assumption that there is a direct relationship between sales and ridership and the number of vehicles needed to provide the transportation service. That is, vehicle needs can be calculated as a percentage of sales.

   b. Given a sales projection, the percentage for each vehicle is multiplied by the increase in sales to determine the increase in required vehicles.

3. To determine financing needs, multiply the number of needed vehicles by their total cost.

   a. Remember to adjust your short-term cash flow budget by the increase in total operating costs attributable to each new vehicle.

   b. Subtract the net income and depreciation projected to result from expected sales from total new vehicle cost. The remainder is the amount of external financing required from external sources.

IV. EVALUATING THE FINANCING OF VEHICLES

Business Questions for Section IV

How can you determine if a vehicle will return more than it costs?

What calculation can you use to determine how long it will take you to recover the cost of a new vehicle?

How does a calculation of net present value help you decide whether or not to invest in a new vehicle?

A. Capital Budgeting:

1. The acquisition of vehicles, which have a useful life of more than a year, is a capital budget decision.

2. Three capital budgeting techniques may be utilized to determine the desirability of investing in vehicles:

   a. Net cash flow.

   b. Payback period.

   c. Net present value.

B. Net Cash Flow:

Will the company get more cash back from an investment in vehicles than it spends?

1. Assume that a company could save $15,000 per year on subcontracted transportation services if it invests $20,000 in a vehicle. Over a three year period, the assumed useful life of the vehicle, the company's net cash flow would be $10,000.

2. **The net cash flow calculation looks like this:**

YEAR	CASH OUTFLOW	CASH INFLOW	NET CASH INFLOW
1	$20,000	$ 0	($20,000)
2	0	15,000	(5,000)
3	0	15,000	10,000

3. Net cash flow analysis is not complete because it fails to take account of timing, the cost of money, inflation and any risk factors. A negative net cash flow will prevent an investment. A positive net cash flow only begins capital budgeting financial analysis.

C. Payback period, or simple payback:

How much time will it take for your company to recover its vehicle investment?

1. **The payback period is calculated** by dividing the original investment by the monthly savings it creates:

$$\frac{\textbf{Original Investment}}{\textbf{Monthly Savings}}$$

2. As a rule of thumb, companies do not buy a vehicle unless the payback period is less than half the useful life of the vehicle. As with net cash flow, payback period is not complete because it fails to take account of time or risk.

3. In our example, the payback period is equal to sixteen months, calculated:

$$\frac{\$20{,}000}{\$15{,}000/12 \text{ months}} = 16 \text{ months}$$

D. Net present value:

How does this investment compare with alternative, available investments? How does it compare with the company's minimum acceptable return on investment, its "hurdle rate?"

1. Net present value allows a comparison of investment return by calculating the amount of money which would have to be invested today to generate total net cash flow over the useful life of the vehicle. It is the total of all savings from the vehicle investment discounted to today's value.

2. In our example, assume that your hurdle rate is 10%, i.e., you have alternative investment opportunities that will yield at least 10%. Using the present value table at

the end of this *Handbook*, discount rates can be established for each of the three years of the vehicle's useful life. A discount rate indicates the amount of money which would have to be invested today to yield one dollar after one year.

3. **Net present value would be then calculated:**

YEAR	NET CASH INFLOW	DISCOUNT RATE	PRESENT VALUE
1	($20,000)	1 .000	($20,000)
2	15,000	0.909	13,635
3	15,000	0.826	11,265
TOTAL	**25,000**	-----	**17,290**

4. Note that net present value is significantly lower than net cash flow. The difference reflects the time value of money, i.e., the capacity of money to earn interest, 10% in our example, over time.

5. Our net present value calculation indicates that by investing in a vehicle our company will realize a net benefit of $17,290 in today's dollars.

6. **How to use net present value:**

   a. If the net present value of an investment is negative, then the actual rate of return on the investment is lower than desired. Negative net present value indicates that an investment in a vehicle is not financially desirable.

   b. If it is zero, the actual rate of return on the investment is equal to your company's hurdle rate. A net present value of zero indicates that an investment in a vehicle is financially acceptable.

   c. If the net present value is positive, the rate of return exceeds your company's hurdle rate. Positive net present value indicates that an investment in a vehicle is financially desirable.

V. DEALING WITH CASH FLOW PROBLEMS

Business Questions for Section V

What can you do when your company's liquidity ratios indicate a shortage of cash?

How can you realistically work with your creditors?

A. Cash flow shortages:

1. Problems with cash flow are common among new, small businesses. They can put you out of business. To overcome cash flow shortages, a company must first determine the cause(s) of the problem and then quickly take corrective measures.

2. **Corrective measures** may include:

   a. Improve the timeliness and follow-up on billings and collections; reevaluate credit policy to customers.

   b. Reduce operating expenses, including cuts in purchases and payroll expenses.

   c. Develop low- or no-cost sales promotion programs.

   d. Drop unprofitable services.

   e. Sell unproductive assets.

   f. Trim back on operations, including sale of some productive assets

   g. Reschedule debt repayment.

B. Don't make matters worse:

1. Make all scheduled tax payments, particularly trust fund moneys, such as sales tax, withholding and social security.

2. Deal with creditors honestly. Keep them on your side, especially trade creditors. Avoid being put on C.O.D. It will add to your cash flow problems.

C. Resolve problems with advisors and creditors:

1. Negotiate with suppliers and other creditors for extensions and moratoriums on payments.

2. Give your creditors confidence that you are seriously attempting to correct the problem. Give them a reason to continue to support you, rather than excuses to cut their losses.

3. Seek help promptly from advisors, such as your lawyer and accountant.

4. Seek outside funds from a partner, friends and family, even a competitor. But, be realistic.

CHAPTER THREE

HOW TO FIND EQUITY AND DEBT CAPITAL

I. INTRODUCTION TO FINANCING

Business Questions for Section I

What is equity, or the owner's investment in a business?

What is debt, or lender's (creditor's) financing?

Why is it critical that you reinvest your profits in your company?

What do lenders mean when they talk about the maturity of your loan?

How will you know if the interest rate on your loan is too high?

What is the difference between a self-amortizing loan and a loan with a balloon payment?

How do loan guarantees work?

A. Equity, or Owners' Capital:

Equity capital is the owners' investment in a company.

1. Owners may include the entrepreneur who starts the company and outside investors.

2. Equity owners share the risk that the company will be profitable. There is no interest rate or obligation of repayment to equity investors.

B. Debt, or Lenders' Financing:

Debt capital is money borrowed from suppliers, private financial institutions or public/private development agencies.

1. Debt capital carries an obligation on the part of the company (the borrower or debtor) to repay the money borrowed, with interest, to its lender (the creditor).

2. Loans are classified as short- or long-term debt.

   a. Short-term debt includes trade credit, lines of credit, loans with maturities of one year or less, and accounts receivable loans.

   b. Long-term debt includes loans with maturities longer than one year, real estate loans, equipment loans and leases.

C. Start-up and Expansion Capital:

Dollars to start and grow your company, to acquire vehicles, facilities and working capital may be generated internally by a niche transportation company, or raised from outside sources.

1. **Internally Generated Funds**: The entrepreneur's equity and retained earnings from profitable operations are sources of internal capital for small companies.

   a. Over 60% of the funds raised by small companies come from internal sources.

   b. Small companies may not be able to attract outside private equity investors. The financial risk of small business lending also makes it more difficult to borrow funds from outside sources.

   c. Most successful small businesses have grown by reinvesting profits, or net income from operations, back into the company. Retained earnings reinvested in the company provide capital to sustain its growth.

   d. Operating efficiency, cost control and adequate profit margins are required to generate internal capital. Higher costs mean lower profits.

2. **Outside Investment**: Types of outside financing include: investors' equity; government and foundation grants; seed capital; trade credit; lines of credit; accounts receivable loans; real estate loans; equipment loans; public/private below market interest rate loans; loan guarantees; and subcontracting for services.

D. Maturity:

The maturity of a loan is the length of time for which the money is borrowed. A small transportation company should match its financial needs to a financing source of the appropriate maturity.

1. Financing needs growing out of short-term or seasonal fluctuations in cash flow may be financed with short-term (up to one year) instruments.

2. Fixed-assets may be financed through long-term financial instruments.

3. Equity investments do not ordinarily have a fixed maturity. Outside equity investors do, however, typically require a business plan and will specify developmental benchmarks in the growth of the company.

E. *Interest Rates:*

For any type of loan, the interest rate charged by the lender is determined by the prevailing market rate of interest, the risk involved in lending in a particular industry, and the risk of lending to the particular borrower.

1. For niche transportation companies, the current "prime rate" is the best indicator of prevailing market rates of interest.

2. Small businesses ordinarily pay a higher interest rate than large companies. This higher rate reflects the higher risk of lending to small businesses and their limited access to the capital markets.

3. Interest rates charged for short-term financing tend to be lower than the interest costs of long-term financing.

4. Interest rates on loans may be fixed or variable.

    a. With a **fixed rate loan**, the interest rate paid by the borrower is set at the time the loan is made and will not change.

    b. With a **variable rate loan**, the interest rate paid by the borrower may periodically change as interest rates change in the capital markets. Ordinarily, these changes are tied to a specified base rate such as the rate on Treasury bonds. Variable rate loans may provide a cap to limit changes in the interest rate charged.

    c. Because the borrower in a variable rate loan assumes interest rate risk, the original interest rate specified for the loan will be lower than the rate on a comparable fixed rate loan.

5. Equity investors do not receive interest payments. As owners of the company, their return on investment comes in the form of dividends (distributions of profits) and capital gains (the increase in the value of the company) and depend upon the company's success.

F. Repayment:

The repayment of principal (the amount borrowed) and interest on a loan, or loan amortization, may take several forms. The two most common forms of loan repayment are self-amortization and balloon payment.

1. With a **self-amortizing loan**, the borrower makes regular, periodic (monthly, quarterly) repayments of principal and interest to the lender. The amount of these debt service payments is calculated to completely repay the loan by maturity.

2. **Balloon payment loans** also involve regular, periodic repayment. The amount of these debt service payments, however, is not sufficient to fully repay the loan. At maturity, the borrower will make a large, final payment, known as the balloon payment.

G. Guarantees:

Federal, state and local government agencies, and some private insurance companies, provide loan guarantees to eligible companies to assist them in obtaining private financing. These agencies take the responsibility of repayment when the borrower defaults, i.e., fails to repay. They may then acquire and sell the collateral, or property used as security for the loan, in order to be reimbursed.

II. GETTING YOUR COMPANY INTO GOOD LEGAL AND ACCOUNTING SHAPE FOR FINANCING

Business Questions for Section II

Why does your niche transportation company need an attorney and an accountant?

What are the advantages and disadvantages of legally organizing your company as a corporation? partnership? association?

What are the advantages and disadvantages of legally organizing your company as a for-profit or non-profit business?

Why is it essential that your company have effective financial reporting and accounting controls?

What does an effective internal accounting system include?

A. Attorneys and Accountants:

Before you can approach investors and lenders to obtain financing, it will be necessary to legally create your company and establish its basic bookkeeping procedures.

1. Most successful small businesses rely upon the services of an attorney and an accountant to help start the company and manage its growth.

2. Investors and lenders may consider the absence of an attorney or accountant to advise the company as a reason for turning down an investment or loan.

3. Attorneys and accountants can be expensive. In many cities, business groups like the Chamber of Commerce, Bar Association and Institute of Certified Public Accountants sponsor programs through which lawyers and accountants offer free, initial counseling for new, small businesses.

B. Legal Considerations:

1. Niche transportation companies may be legally organized as a corporation, partnership or association.

   a. **Corporation**:

i. A business organized as a corporation is owned by its stockholders and run by its board of directors and hired management. As a legal entity separate from its shareholders, a corporation is responsible for its own liabilities. Shareholders bear no personal liability for the business activities of a corporation. They may only lose their investment in the company. A shareholder's stock may be sold without the permission of the corporation. Corporations do not dissolve upon the death of a stockholder.

ii. A corporation pays income taxes on its profits. Any remaining profits distributed to shareholders as dividends are then separately reported and taxed on the shareholder's individual income tax return. There is double taxation of corporate profits.

iii. Special **Subchapter S corporations** are taxed only once, on the stockholder's income tax return. Niche transportation companies may qualify as Subchapter S corporations.

b. **Partnership**:

i. A partnership is a company with two or more owners, or partners. At least one partner must be a "general partner" who helps manage the company and bears personal liability for partnership debts and losses. Each general partner has the authority to enter into agreements that are binding upon the partnership. Some partnerships also have "limited partners," investors who do not participate in company management and bear liability only to the extent of their investment in the business. A partner's interest in the partnership may not ordinarily be sold without the permission of the partnership. The death of a general partner will dissolve the partnership.

ii. Partnerships are not themselves taxed. Each partner's share of business income, expenses and losses is reported on his or her individual income tax return. There is no double taxation of partnership profits.

c. **Association**:

i. Associations are organizations that share the characteristics of both corporations and partnerships.

ii. An association may be taxed as a corporation or a partnership depending upon its business characteristics.

(a) An association will be taxed as a corporation if it has members, is organized to carry on a business, divides the gains from business activities, and has a majority of the following corporate characteristics: continuity of life, centralized management, limited liability and free transferability of ownership interests.

(b) The Internal Revenue Service evaluates associations on a case-by-case basis to determine their tax status.

2. Niche transportation companies may legally be organized on a for-profit or a non-profit basis.

   a. **For-profit**: Corporations, partnerships and associations operated on a for-profit basis pay taxes.

   b. **Non-profit**: Corporations and associations, but not partnerships, operated on a non-profit basis may not have to pay taxes if they meet the standards for tax-exempt organizations specified by the Internal Revenue Service.

      i. Generally, niche transportation companies may qualify as tax-exempt organizations under **Section 501 (c) 93) of the Internal Revenue Code** if they are organized for such charitable purposes as: relief of the poor, distressed or underprivileged; the lessening of government burdens; the reduction of neighborhood tensions; or they combat community deterioration and juvenile delinquency.

      ii. A description of the qualifications for tax-exempt status can be found in Internal Revenue Service Publication 557, "Tax-Exempt Status for Your Organization."

      iii. In addition to the benefit of exemption from taxes, non-profit transportation companies may be eligible for government support not available to for-profit companies.

C. Accounting Considerations:

1. A company's ability to develop a sound financial plan and obtain outside financing depends upon having effective company financial reporting and accounting controls.

   a. An effective financial reporting system includes:

      i. An accounting system to collect information on sales, disbursements, collections and payables.

      ii. A cost accounting system based on the all-in cost of service per hour.

iii. Accurate, up-to-date income statements, balance sheets and statements of cash flow.

iv. Monthly, quarterly and annual monitoring and evaluation of financial performance against business and financial plan projections.

b. Effective internal control systems include controls on:

i. The receipt and depositing of cash.

ii. Cash collections and management.

iii. Cash disbursements.

iv. Purchases of materials.

v. Purchases of vehicles and other capital equipment.

vi. Payroll expense and time reporting.

III. EQUITY FINANCING: USES, SOURCES, AGREEMENTS

Business Questions for Section III

How is equity capital used by small transportation companies?

When compared with a loan, does equity capital have advantages? disadvantages?

Where can you find additional equity capital?

A. Equity Capital:

The dollars invested in the company by its owners, ordinarily in the form of stock ownership, is called equity capital.

B. Uses of Equity Capital:

1. Equity capital is ordinarily used to help a company get started and to finance its expansion. It may be invested by the founding entrepreneur, or raised from outside investors.

2. For niche transportation firms, equity capital may be used to acquire vehicles, set up a garage and maintenance facilities, or as working capital to cover salaries, gas, insurance and other operating costs as the business generates first sales and cash flow.

C. Advantages of Equity Capital:

1. Equity investors share the risk that the company will be profitable. They invest in the company on a permanent basis. There is no obligation of repayment.

2. Equity investment improves a company's credit-worthiness. It reduces the company's debt-to-equity ratio, increasing the financial stability of the company and the likelihood that it can get debt financing.

3. Equity capital does not require interest payments. It is not a drain on the company's cash flow.

4. Equity investors ordinarily require a business plan, including benchmarks toward profitability, that the new company should meet. Developing a business plan helps the entrepreneur determine the company's goals and objectives and decide upon effective management strategies to achieve them.

5. Outside equity investors may add expertise to the company's board of directors, enhancing the management expertise of the firm.

D. Disadvantages of Equity Capital:

1. Equity financing dilutes the entrepreneur's share of ownership. The founders of the business ordinarily must share control, decision-making and profits with outside equity investors.

2. Equity investors, unless they sell their stock, will always remain owners of the company. When they sell their stock, the entrepreneur will have new co-owners with whom to work.

3. Equity investment is not appropriate for every company. Outside investors typically look for high growth and return on investment. Few new, small niche transportation companies will meet the investment requirements of most outside private equity investors.

E. Sources of Equity Capital:

Equity capital may be raised from founding entrepreneurs, government and foundation grants, informal investors, Small Business Investment Companies (SBICs) and Minority Small Business Investment Companies (MESBICs), seed and venture capital funds, and through retained earnings, or the accumulated profits generated by company operations.

1. **Founding entrepreneurs**:

   a. Ordinarily, the entrepreneur starting a company will be its first equity investor. Entrepreneurs fund their investment through savings and personal loans, including home equity loans.

   b. "Sweat equity" is frequently the entrepreneur's largest equity contribution. It is the ideas, time and energy he or she invests in the new company.

2. **Government** and **foundation grants**: Grant funds are provided to qualified businesses without an obligation to repay. They may be used by the company as if they were equity. Grant dollars, for example, count as equity when calculating debt-to-equity and other financial ratios.

a. Federal grant funds for niche transportation companies are available through FTA's Entrepreneurial Services Program (ESP). ESP is described in greater detail in **Chapter Three, Section VI.B.1., page 57.**

b. **Foundation grants**: Private foundations offer grants to qualified community development projects including community-based niche transportation companies. Directories of foundations and their criteria for eligibility may be found in most larger public and university libraries.

3. **Informal Investors**: Informal investors include the entrepreneur's family, friends and colleagues in the community. They may also include "angels," wealthy individuals that make equity investments in emerging companies. Angels are frequently other successful entrepreneurs, business people and business development professionals.

   a. Informal investors look primarily for an acceptable return on their investment given the investment risk they are assuming. They may also enjoy working with new companies.

   b. To identify informal investors, talk with your accountant, attorney and banker as well as seed and venture capitalists, universities and entrepreneurs' clubs in your area.

4. **Seed and venture capital funds**: Seed and venture capital funds invest equity and long-term debt in developing companies.

   a. Seed and venture capitalists generally have minimum investment size requirements and require rapid company growth and high investment returns.

   b. Important factors seed and venture capitalists consider when evaluating an investment include: the company's management team, the growth potential of the company and its market, projected returns on investment, their ability to sell their investment, and the company's insulation from competition.

5. **SBICs and MESBICs**: These are privately owned and operated venture funds sponsored by the United States Small Business Administration (SBA). They make equity and long-term debt investments in new, small companies.

   a. SBICs and MESBICs compete with seed and venture funds for their capitalization. In addition, they receive substantial financial assistance from SBA.

   b. SBICs and MESBICs are often less demanding than seed and venture funds in their investment criteria for new, small businesses.

IV. SHORT-TERM FINANCING: USES, SOURCES, AGREEMENTS

Business Questions for Section IV

Why is access to short-term loans important to niche transportation companies?

What is trade credit? How can your company use it? Where can your company find it? What are the terms and conditions of a trade credit agreement?

What is a line of credit? How can your company use it? Do commercial banks and finance companies provide it? What are the interest rate, maturity and repayment, and collateral terms and conditions of a line of credit agreement?

How do commercial loans, revolving credit and accounts receivables loans differ from one another? How can your company use them? Where can you apply for them? What are the terms and conditions of these different types of short-term loans?

A. Short-Term Borrowing:

The most important source of outside investment in small companies is short-term lending.

1. Companies need cash to grow. Seasonal fluctuations in cash flow or a firm's cash collection cycle may require short-term borrowing to meet cash shortages.

2. Most short-term financing used by businesses in the United States is not supplied by financial institutions.. It is made up mainly of trade credit (accounts payable) and accrued expenses.

3. Financial institutions, however, do offer a variety of short-term borrowing arrangements to niche transportation businesses.

B. Three Types of Short-Term Financing:

1. Trade credit.

2. Line of credit.

3. Short-term loans.

C. Trade Credit:

Trade credit is a loan advanced in the form of deferred and/or discounted payments by a company to its suppliers of goods and services.

1. **How companies use trade credit**:

   a. Trade credit provides short-term, interest free working capital to a company. It is used to finance the purchase of goods and services.

   b. Roughly 1/3 of the outside capital raised by small companies is trade credit.

   c. Trade credit is a loan of goods and services, instead of money. It is based on the credit terms that a company establishes with its suppliers.

   d. Trade credit takes the form of extended payment terms (30, 60 or 90 days) and/or a discount for early cash payment.

   e. Trade credit, and other current liabilities, tend to increase spontaneously as sales increase. This increase in borrowings matching sales growth may not, however, be sufficient to meet a growing business' short-term capital needs.

2. **Sources of trade credit:**

   a. Trade credit is not provided by banks or other financial institutions. It is provided by a company's suppliers of goods and services.

   b. Accrued expenses are similar to trade credit. They are liabilities for services received for which payment has not yet been made. The most common accruals are wages and taxes. Accruals are a free source of financing that may be used cautiously, provided that they do not harm employee morale or affect the company's credit rating.

3. **Major terms and conditions in the trade credit agreement:**

   a. **Interest rates**:

      i. During the extended payment, or credit period, trade credit is interest free.

      ii. Following the extended payment period, effective rates on trade credit can be high relative to other short-term loans.

      iii. Paying your bills on the last day of the discount period for early payment, whenever possible, is generally the best cash management procedure for small businesses.

b. **Maturity and payment**:

i. A company's credit terms with its suppliers state the credit period, the size of the cash discount, the cash discount period, and the date the credit period begins.

ii. For example, the selling terms "2/10, net 60" mean that the company gets a discount of 2% if it pays the supplier in cash by the tenth day following the date of the invoice. Otherwise, the full amount is due 60 days following the invoice. After 60 days, interest may be charged.

c. **Collateral**: Trade credit financing is unsecured and informal.

D. Line of Credit:

With a credit line, the lender loans a company funds, as needed and at company request, up to the maximum dollar amount specified in the loan agreement. The loan is repaid as the company receives cash from collections on its sales.

1. **How companies use a credit line**:

a. A credit line fills temporary shortages in cash brought about by timing differences between cash outlays for expenses and cash collections from sales.

b. It may be used to finance receivables or for project work where cash outlays are required in advance of payment.

c. A credit line provides a company with flexibility in the amount and duration of its outstanding loans.

2. **Sources of credit line financing**:

a. Commercial banks and finance companies provide line of credit financing.

b. Commercial banks generally have high creditworthiness criteria for small business loans. Certain commercial banks, however, have specialized small business loan officers and may have lending programs for minority- and women-owned businesses.

3. **Major terms and conditions in the credit line loan agreement:**

a. **Interest rates:**

i. Interest on a credit line is paid only on the amount actually borrowed by a company.

ii. In addition to interest, lenders may charge a commitment fee to pay the bank for reserving funds for the company's use.

iii. Banks may fully or partially waive commitment fees if the company maintains a compensating balance on deposit with the bank throughout the loan period.

b. **Maturity and repayment**:

i. Credit line agreements usually set an annual dollar limit on the company's loan.

ii. Credit line loans are repaid as the company realizes revenue, i.e., collects cash for services rendered from its customers.

iii. Small companies are frequently required to have a clean-up period during the year when no borrowing occurs and the credit line loan has been fully paid up.

c. **Collateral**:

i. Credit lines are based on the cash collection cycle of the firm, the period of time from the creation of accounts payable through sale and the creation of accounts receivable to actual receipt of cash payment by the company. A company track record of cash collections is ordinarily required to receive a credit line.

ii. Security, or collateral, for a line of credit may include: accounts receivable, inventory, other current assets, fixed assets, public/private and/or personal guarantees.

iii. A credit line can be unsecured. The cash position, timeliness of the cash collection cycle, and the overall financial strength of the company determine the likelihood of its receiving an unsecured credit line.

E. *Short-Term Loans:*

Commercial Loans, Revolving Credit and Accounts Receivable Financing.

1. **How companies use short-term loans**:

a. Short-term loans may be used for seasonal build-ups of inventory or receivables or to pay lump sum expenses, such as taxes or insurance.

b. **Commercial Loans**: Short-term loans may be based primarily on the earnings history and solid financial condition of the business. These commercial loans are ordinarily made to seasoned, creditworthy companies, and may be unsecured.

c. **Revolving Credit**: Short-term loans can take the form of a revolving loan agreement. The business may borrow and repay the loan several times during the revolving period up to the maximum dollar amount specified in the loan agreement.

   i. Revolving loans may be converted into term loans at the end of the revolving period.

   ii. Due to the unproven nature of a small business borrower's cash conversion cycle, lenders providing revolving credit ordinarily prefer the added security of the annual clean-up period used with credit line financing.

d. **Accounts Receivable Loans**: Another form of short-term borrowing is accounts receivable financing. The value of a company's future collections from sales is the primary security for this type of loan.

   i. Accounts receivable financing lets an undercapitalized company obtain working capital on a regular and continuous basis.

   ii. A lender will advance funds based on a percentage of accounts receivable. For example, the amount of the loan may be 65 to 80 percent of company receivables less than 60 days old.

   iii. The actual percentage of accounts receivable which can be financed varies with their quality, the creditworthiness of the company's customers, and the historical cash conversion cycle of the company.

   iv. Accounts receivable may also be factored, i.e., sold outright, providing a company with cash even though the receivable has not yet actually been collected. Factoring accounts receivable can relieve a company of its credit and collection concerns.

2. **Sources of short-term loan financing**:

   a. Commercial banks, finance companies and factoring companies have been a traditional source of short-term and, particularly, accounts receivable financing for small companies.

   b. Commercial banks may not be available to small companies seeking short-term financing. Certain commercial banks participate in public/private loan and loan guarantee programs and provide short-term loans to small businesses.

c. Finance companies ordinarily rely upon the value of collateral, e.g., accounts receivable, when making a short-term loan. They can be a good source of capital for new, small companies whose credit ratings are weak. Finance companies may also be active lenders in public/private loan and loan guarantee programs.

d. Factoring companies purchase accounts receivable and then receive payment directly from a company's customers. They concentrate more on the financial position of the customers than that of the company itself.

3. **Major terms and conditions in the credit line loan agreement:**

a. **Interest rates:**

i. With revolving loans, interest is paid only on the amount actually borrowed.

ii. The cost of accounts receivable financing is higher than the cost of other short-term financing methods due to collection risk and high administrative costs.

iii. While factoring companies do not charge interest as such, they ordinarily purchase receivables at a discount, i.e., less than their face amount, to reflect their collection costs and risks and their return on investment. This discount can be quite high, making factoring a costly form of short-term financing.

b. **Maturity and repayment**:

i. Short-term loans have a maturity of less than one year. The term is generally 30, 60 or 90 days.

ii. Generally, short-term commercial loans are repaid in a lump sum at maturity out of the cash conversion cycle of the company.

iii. Revolving loans are ordinarily repaid in monthly installments of interest plus principal.

iv. Revolving loans may be continued into the next year following annual review and renewal. This type of revolving loan does not require annual clean-up.

v. Accounts receivable loans are repaid as customers pay their bills to the company.

vi. Accounts receivable financing can work as a continuous source of funds for working capital, but may be subject to annual review and renewal by the lender.

c. **Collateral**:

i. Short-term loans may be secured or unsecured.

ii. If a company's financial position is strong, particularly its cash position, the loan may be unsecured. Roughly 1/2 of short-term loans for small companies are unsecured.

iii. If the financial condition of the borrower or its cash conversion cycle are weak, collateral in the form of current assets, fixed assets, public/private and/or personal guarantees may be required as security.

iv. With an accounts receivable loan, the lender takes a security position in a company's accounts receivable. These loans may also involve varying degrees of control and auditing by the lender.

V. LONG-TERM FINANCING: USES, SOURCES, AGREEMENTS

Business Questions for Section V

How are long-term loans used by small transportation companies?

What are term loans? How can your company use them? What are the sources of term loan financing? What are the requirements of term loan agreements?

How are leases used to finance the purchase of vehicles? What are the sources of lease financing?

How do financial and operating leases differ from one another? What are the different rent, maintenance, lease maturity and collateral terms and conditions of vehicle leases?

A. Long-Term Borrowing:

Long-term financing may be used by niche transportation companies to finance fixed assets, permanent working capital, and to expand.

1. **Fixed-assets** include land, buildings and equipment. Fixed-assets used by niche transportation companies include their vehicles and, for more mature companies, may also include buildings and equipment for maintenance facilities and offices.

2. **Permanent working capital** is the total amount of cash a company needs from the beginning to the end of the service delivery, or cash conversion, cycle.

   a. For a niche transportation company, the service delivery cycle begins when it creates accounts payable by acquiring the assets it needs to operate its service. With sales and service delivery, the company creates accounts receivable which, in turn, are collected and converted into cash for the company.

   b. The total amount of cash the company needs to complete this cash conversion cycle is its permanent working capital.

3. Most long-term financing used by businesses in the United States is supplied by financial institutions, including commercial banks and finance companies.

B. Two Types of Long-Term Financing:

1. Term loans.

2. Leases.

C. Term Loans:

Term loans are long-term secured credit provided to a company to finance capital equipment and permanent working capital. Loan repayment may be self-amortizing or end with a balloon payment.

1. **How companies use term loans**:

   a. Term loans may be used to finance fixed-assets, permanent working capital, business expansion, and to refinance existing debt, particularly debt at higher interest rates.

   b. An **equipment loan** is a term loan secured by the equipment it is used to purchase.

      i. Niche transportation companies may use equipment loans to purchase vehicles.

      ii. Lenders will loan from 60 to 80 percent of the value of the equipment being purchased.

   c. A **real estate loan** is a term loan secured by the land and/or buildings it is used to purchase.

      i. A niche transportation company may eventually use a real estate loan to purchase maintenance and office facilities.

      ii. Real estate loans are usually made for up to 75 percent of the appraised value of the real estate being financed. That is, the loan-to-value ratio on a real estate loan may be as high as 75%.

2. **Sources of term loans**:

   a. Commercial banks are the major suppliers of term loans for small companies. Commercial banks may participate in public/private loan and loan guarantee programs.

   b. Term loans are also provided by finance companies. They tend to rely more on collateral than cash flow when making lending decisions. They may also participate in loan guarantee programs.

c. The seller of equipment may offer financing to his or her customers.

d. Foundations offer loans to qualified applicants, ordinarily at reduced interest rates.

e. Federal, state and local government agencies are also a direct source of term loans for new, small businesses, particularly for the purchase of fixed assets.

   i. These public/private programs may be targeted on companies creating low- and moderate-income jobs.

   ii. They may provide loans to qualified borrowers at interest rates lower than those charged by private lenders.

f. Commercial banks and finance companies are more likely to provide loans with maturities of up to 7 years. Long-term loans with up to 30 year maturities are more likely to come from public/ private sources.

3. **Major terms and conditions in the term loan agreement**:

   a. **Interest rates**:

      i. The interest rate on a term loan can be fixed or variable, i.e., adjusted periodically during the life of the loan.

      ii. Interest rates are based on the size of the loan, its maturity, the size and financial condition of the borrower.

      iii. The interest rates charged by government-supported lenders range as low as 1% and as high as the prevailing market rate.

   b. **Maturity and repayment**:

      i. Unlike short-term loans, which are repaid from a company's cash conversion cycle, term loans are paid from long-term earnings.

         (a) Profitability and cash flow from operations are two key factors lenders consider when making term loans.

         (b) The overall capital structure of the firm (e.g., its debt-to-equity ratio) is also an important consideration.

      ii. The maturity of a term loan is based primarily on the useful life of the asset it is being used to finance.

iii. Term loans are repayable monthly, quarterly or semi-annually and may be self-amortizing or balloon payment loans.

c. **Collateral**:

i. Longer-term loans are more likely to be collateralized than short-term loans due to their higher risk.

ii. Equipment loans are secured by a lien in favor of the lender against the equipment. Real estate loans are secured by a lender's lien on the property. This lien is called a mortgage or deed of trust.

iii. Lenders may require additional security for their term loan, particularly if the borrower is a new business. This additional security may take the form of public/private and/or personal guarantees

iv. Compensating balances are often required with longer-term loans.

v. Lenders may also place financial controls on the borrower to reduce loan risk. These controls may require the company to maintain certain levels of working capital and acceptable financial ratios, and/or to receive lender approval before borrowing additional funds, paying dividends or changing management.

D. Leases:

A lease is a contract between an owner of property, the lessor, and the user of that property, the lessee, for a specified period of time and a specified rental payment.

1. **How companies use leases**:

a. A niche transportation company may lease, or rent, its office space and maintenance facilities. Lease financing may also be used to acquire equipment and, particularly, vehicles. This section of the ESP *Financing Handbook* concentrates on equipment leasing for vehicles.

b. There are two types of equipment leases: financial leases and operating leases.

c. The **financial lease** generally covers the entire useful life of a vehicle.

i. Total payments by the company (the lessee) in a finance lease equal the full value of the equipment.

ii. Financial leases cannot usually be cancelled.

   iii. Ownership of the vehicle passes to the lessee at the end of the lease. The lessee is responsible for selling the vehicle for its remaining value.

d. **Operating leases** are written for shorter periods of time than financial leases, i.e., for less than the useful life of the vehicle.

   i. The company's total rental payments cover only a portion of the vehicle's value.

   ii. Operating leases may be cancelled by the lessee, but may require the payment of a cancellation penalty to the lessor.

   iii. The lessor keeps the vehicle at the end of the lease term and is responsible for resale.

e. Vehicle leases may provide full or partial maintenance services.

   i. With a **full-service lease**, maintenance is provided by the lessor and paid for through the company's rental payments.

   ii. Leases may also place maintenance responsibilities on the lessee. Rental payments under **partial-service leases** will be lower than under full-service leases. Lessors may, however, be able to provide maintenance at a lower cost than a niche company.

   iii. In a financial lease, maintenance is ordinarily the company's responsibility.

2. **Sources of lease financing**: Leasing companies, commercial banks, commercial finance companies, and the manufacturer or owner of equipment are sources of lease financing.

3. **Major lease terms and conditions**:

   a. **Rent**:

      i. The total cash payments on a lease may be greater than the total cost of purchasing a vehicle and financing the purchase with a loan.

      ii. After-tax costs must be compared in order to accurately compare the relative costs of leasing and purchasing.

      iii. Lease payments are ordinarily fully deductible from a for-profit company's income tax return. Only interest payments may be deducted if a vehicle is purchased with borrowed funds. The owner of a vehicle may also deduct depreciation on its tax return. Lessees cannot take a depreciation deduction.

b. **Maturity and payment**:

i. Generally, vehicle leases are 2 to 4 years in maturity. However, leases for as little as 18 months may be obtained.

ii. An up-front payment of as much as 10% of the value of the vehicle may be required. There are, however, leasing companies that require only the first month's rent to enter into a lease.

iii. Rental payments are ordinarily made monthly.

c. **Collateral**:

i. Companies seeking a vehicle lease are subject to the same type of credit review they undergo when seeking a loan.

ii. Lessors are particularly interested in the cash flow of the company over the life of the lease to be certain that it will be able to pay its rent. The value and useful life of the vehicle will also be considered.

iii. Since the lessor remains the owner of the vehicle during the term of the lease, it has the right to repossess the vehicle if rental payments are late or in default.

VI. GOVERNMENT FINANCING FOR SMALL BUSINESS

Business Questions for Section VI

How can an FTA Entrepreneurial Services Program grant help your company pay one-time start-up costs?

What are the eligibility criteria for an FTA Section 16(b)(2) capital assistance grant to help pay 80% of your company's vehicle purchase costs?

Do you need to have a relationship with a private commercial bank to use a Small Business Administration loan guarantee?

Will an SBA Certified Development Company make a loan to a new niche transportation company?

Where do you apply for a loan funded with a HUD Community Development Block Grant?

How can the Job Training Partnership Act and Targeted Jobs Tax Credits be used to help cover your training and employment costs?

What types of state and local business finance programs may be available to your company? Are loans available? loan guarantees? tax incentives? enterprise zones?

A. Federal Business Finance Programs:

Several Federal agencies, including FTA, the Small Business Administration (SBA) and the Department of Housing and Urban Development (HUD), administer programs that can support the development and expansion of small niche transportation companies.

B. Federal Transit Administration:

1. **Entrepreneurial Services Program (ESP)**:

   a. ESP was created to stimulate new passenger transportation businesses which can address community needs without continued reliance on Federal resources. Particular emphasis is given to services created by small businesses, with minority participants and maximum community support.

b. One time start-up funding is made available to entrepreneurial niche transportation companies through an ESP grant. These grants have ranged from $10,000 to over $400,000.

c. ESP companies should become financially self-sustaining within two years following start-up. Farebox revenue, private contributions and other non-Federal funding sources must sustain the company.

d. Generally, ESP grants are available for market-oriented transportation services designed to complement the services provided by local public transit agencies or private operators.

e. ESP grants may be used for planning and investment support. For example, they have been used to cover the cost of technical planning for new routes, the development of marketing plans, and certain capital costs of vehicle leasing.

f. An application for an ESP grant must be submitted to FTA through a public sponsor, e.g., a local transit agency, city, county or metropolitan planning agency. ESP funds flow through the local sponsor to the ESP company.

g. There are no special forms required for an ESP grant application. FTA will, however, review the company's business, service and financing plans and management structure before making an ESP grant.

2. **Section 16(b)(2) Capital Assistance**:

a. Under this program, private non-profit organizations may apply for FTA capital assistance to purchase new vehicles and equipment to provide needed transportation services for elderly and handicapped persons.

i. Section 16(b)(2) funds may be used to pay 80% of the purchase costs of vehicles and other eligible equipment such as communications equipment, wheelchair lifts and ramps.

ii. 20% of purchase costs must come from non-Federal sources. Community Development Block Grants from the Department of Housing and Urban Development are, however, treated as non-Federal funds under Section 16(b)(2).

b. Shared use of vehicles purchased with Section 16(b)(2) funds is permitted.

i. When a vehicle is not needed for specific grant related purposes, it may be used to provide services to other elderly and handicapped persons.

ii. After the needs of the elderly and handicapped have been addressed, a vehicle may be used for transportation of the general public on a space available basis, if such use is incidental to its primary purpose and does not interfere with its use for elderly and handicapped persons.

iii. Vehicles may also be used for non-mass transportation social service activities if such use is incidental to its primary purposes.

iv. Vehicles may be leased to private for-profit companies where such companies could not otherwise provide required services and where such arrangements result in more efficient and effective service for the elderly and handicapped.

c. The Section 16(b)(2) program is administered for FTA by State Departments of Transportation and related agencies.

i. Applications for funding are ordinarily accepted only once per year.

ii. Applications are evaluated on the following criteria:

(a) The need for the new transportation service, in addition to the services already provided by public transportation, demand-responsive operators and social service agencies.

(b) The extent to which the service is coordinated with existing service. Applicants in urbanized areas must have their proposed projects included in the local transportation plan.

(c) The applicant's demonstrated ability to sustain the operation of the service.

(d) The extent to which the proposed service will serve the general elderly and handicapped population as opposed to a restricted clientele.

iii. An applicant's proposed service must be described in a public notice that invites comments from interested public or private for-profit transportation service operators.

C. Small Business Administration:

1. **SBA Section 7(a) Loan Guarantees**:

a. **How companies use SBA loan guarantees**:

i. Under the Section 7(a) Loan Guarantee program, funds are loaned to a company by a private lender and partially guaranteed by SBA. If the company defaults, SBA will pay the lender the outstanding balance on the loan plus accrued but unpaid interest.

ii. SBA will guarantee up to 90% of a loan up to $155,000, and 85% of a larger loan up to a maximum guaranteed amount of $750,000.

iii. Applicants for SBA loan guarantees include any small, for-profit business. Niche transportation companies may qualify if their average gross sales for the past three years do not exceed $3,500,000.

iv. A guaranteed SBA loan may be used to finance building construction, conversion or expansion; to purchase equipment, facilities, machinery, supplies or materials; or for working capital. SBA will also guarantee seasonal lines of credit.

b. **Sources of guaranteed SBA loans**: Commercial banks and finance companies serve as SBA guaranteed lenders.

c. **Major terms and conditions in guaranteed SBA loan agreements**:

i. **Interest rates**:

(a) Interest rates are negotiated between the company and its lender. Fixed and variable rate loans may be guaranteed.

(b) The interest rate may not be higher than 2.25% above the prime rate for loans with maturities of under seven years, or 2.75% over prime if loan maturity is over seven years.

ii. **Maturity and repayment**:

(a) The maturity of an SBA guaranteed loan depends on the use of the loan proceeds.

(b) Maximum loan maturities range up to seven years for working capital loans and twenty-five years for real estate loans.

(c) A guaranteed loan to purchase vehicles will have a maturity based upon the useful life of the vehicle.

(d) SBA guaranteed loans are self-amortizing. No balloon payment loans are permitted.

iii. **Collateral**:

(a) When evaluating applications for loan guarantees, SBA requires a company to demonstrate, either through past financial performance or projected financial statements, its ability to repay the loan.

(b) The company must be able to demonstrate to SBA that it has not been able to obtain the necessary financing from private lenders at reasonable terms and conditions.

(c) SBA will review the company's credit history, its reputation and that of its owners and managers, the experience and depth of its management, the soundness of its business and the use to which it will put the loan, and its long-range prospects for success.

(d) An applicant must have sufficient equity to cushion financial difficulty.

(e) Guaranteed SBA loans ordinarily require collateral.

(f) SBA typically requires personal guarantees from directors, managers and the owners of 20% or more of the business to assure repayment.

(g) If a company defaults on its loan, SBA may acquire and sell the collateral. It is SBA policy, however, not to sell the collateral if there is a reasonable prospect of repayment.

2. **SBA Section 504 Certified Development Company (CDC) Financing:**

a. **How companies use Section 504 CDC loans:**

i. SBA's Section 504 CDC program provides fixed asset financing to small businesses.

(a) Section 504 financing combines a loan from a CDC for up to 40% of project costs with a first mortgage loan from a private lender for up to 50% and a minimum 10% equity contribution which may be provided by the company in cash or property, or by the CDC.

(b) The CDC's portion of a 504 financing may range from $25,000 to $500,000.

(c) CDCs may also purchase assets and lease them to a company for a minimum of five years. A CDC may maintain and insure the asset leased to a company.

ii. Only for-profit businesses are eligible for CDC financing.

(a) Eligible CDC borrowers must have a net worth of $6,000,000 or less and average after tax profits for the last 2 years of $2,000,000 or less.

(b) Their projects must demonstrate a significant economic impact on the community. At least 1 job opportunity must be directly created or retained for each $15,000 of CDC loan. This standard may be reduced for projects with strong community benefits.

iii. CDC loans may be used for land, buildings, equipment, new construction or the modernization of existing facilities. Equipment must have a minimum useful life of 10 years to be eligible for CDC financing. CDC loans may not be used for working capital.

b. **Sources of Section 504 CDC loans**:

i. SBA has certified over 400 state-wide and local CDCs.

ii. Private first mortgage CDC lenders include: commercial banks, finance companies, savings and loans, insurance companies, pension funds, state and local development lending agencies.

c. **Major terms and conditions in the Section 504 CDC loan agreement**:

i. **Interest rates**:

(a) CDC loans carry market interest rates.

(b) First mortgage loans also pay market rates of interest. They may be fixed or variable rate loans.

ii. **Maturity and repayment**:

(a) The maturity of Section 504 loans is based upon the useful life of the assets acquired with loan proceeds.

(b) CDC loans have maximum maturities of 20 years for real estate and 10 years for equipment.

(c) First mortgage loans may have maturities of 10 or more years for real estate and 7 years for equipment.

(d) 504 loans are ordinarily self-amortizing. Balloon payment loans may be permitted.

iii. **Collateral**:

(a) The company must be able to demonstrate that it has not been able to obtain the necessary financing.

(b) Section 504 loans are available to healthy and expanding small businesses that show adequate cash flow to repay the loan, sufficient working capital and collateral. 504 loans are not ordinarily available to start-up companies.

(c) CDC loans are fully collateralized. A first mortgage is held by the private lender. SBA is secured with a second mortgage.

(d) SBA requests the personal guarantee of any person owning 20% or more of the company.

D. Department of Housing and Urban Development (HUD):

1. **Community Development Block Grants**: HUD provides Community Development Block Grant (CDBG) funds to cities and states which may use them to make investments in for-profit and non-profit businesses.

    a. Each city and state determines how best to use its CDBG funds for economic development. They may set up revolving loan funds, subsidize interest rates, and/or provide loan guarantees.

    b. Each CDBG-funded economic development program has its own specific financing agreement terms and conditions.

2. HUD regulations require that CDBG-funded economic development assistance is "necessary or appropriate." This standard ensures that the amount of financial assistance is reasonable considering a company's actual needs and the community benefits to be derived from its project.

    a. Financial need is determined through an evaluation of the applicant's balance sheet, income statement and cash flow projections. The applicant should have also cross checked their project costs against industry standards.

    b. CDBG financial assistance may be provided when:

        i. A company faces a financing gap and has been able to only raise a portion of the needed debt and equity capital from private investors;

        ii. Project return on investment is not sufficient to motivate reasonable investors;

        iii. A company's liquidity or coverage ratios are insufficient to generate private financing; and/or

iv. Cost differentials resulting from the location of the company must be overcome.

c. CDBG funding supplements, but does not substitute for, private financing. The availability of private matching funds must be verified.

d. Community, or public, benefits may include:

i. Permanent jobs to be directly created or retained, or jobs created through a direct and positive link with the CDBG-assisted activity;

ii. Other development stimulated by the project;

iii. Increases to the tax base; or

iv. Increases in needed services which result from the project.

3. Investment in niche transportation companies can meet HUD's national objectives for CDBG assistance:

a. By directly creating or retaining jobs, a majority of which are for low- and moderate-income individuals; and

b. By providing a commercial service to a low- and moderate-income neighborhood.

4. Interest rates on CDBG-funded loans should provide the maximum return to the state or local lender while maintaining the economic health of the project. The interest rate on the loan should be balanced against available cash flow.

E. Job Training Partnership Act (JTPA) and Targeted Jobs Tax Credits (TJTC):

1. **JTPA** provides both classroom and on-the-job training for members of economically disadvantaged households.

a. Classroom training is provided to participants based upon an employers personnel requirements and may be held at the place of employment or at area vocational and technical schools and community colleges.

b. Employers using on-the-job training, or OJT, receive a reimbursement of 50% of the participant's salary during the training period.

2. **TJTC** provides a Federal tax credit equal to 40% of the targeted participant's first year wages up to a maximum credit of $2,400.

3. Many state and some local governments also maintain training and tax credit programs to assist in the hiring of low- and moderate-income and other targeted groups. These training programs are frequently supported by the U.S. Department of Labor through JTPA and the Department of Health and Human Services (HHS) in its JOBS program.

F. State and Local Business Finance Programs:

State and local governments have financing programs to support small business development. These programs include direct loans, loan and equity guarantees, tax incentives, and enterprise zones.

1. **Loans**: State and local government direct loans are similar to the loans businesses receive from private lenders.

    a. Program regulations assure that taxpayer funds are protected and that the loan is used for productive and targeted purposes.

        i. Credit review criteria for public/private state and local loans are typically very similar to the analysis used by private lenders.

        ii. Lending decisions often, however, also involve public policy considerations such as job creation, community economic development, closing the financing gap, and tax base growth.

        iii. State and local development loans frequently require matching private sector investment by the entrepreneur and private lenders.

    b. Loans rarely come directly from the state or local government. State constitutional limitations ordinarily require the creation of a public/private agency or authority with an independent board of trustees or directors to legally serve as the program lender.

    c. Major terms and conditions of state and local business development loans:

        i. Most state and local business development loans are for longer maturities than private loans.

        ii. They typically pay for fixed assets which serve as collateral for the loan. There are, however, working capital loans available in many states.

        iii. State and local loans may charge market rates of interest, or may only charge subsidized, below market rates.

2. **Loan Guarantees**: Many state and local governments offer borrowers full or partial loan guarantees similar to the guarantees offered by SBA.

   a. Loan guarantee programs are used when governments want private lenders to provide funding or to share in the risk of extending credit. They require a smaller budget appropriation than direct lending programs since only a loan loss reserve must be funded.

   b. Loan guarantee programs reduce the lender's risk, making debt capital more available or more affordable to business borrowers.

   c. Generally, state and local loan guarantee programs require a commercial lender to evaluate the creditworthiness of the applicant for the loan, to service the loan and monitor repayment. Credit standards for loan guarantees may be similar to the criteria used to evaluate the loan itself.

   d. Most agencies charge the borrower a fee for their loan guarantee.

   e. A few states offer equity guarantees to the owners of targeted businesses. These programs often target minority and economically disadvantaged business owners.

3. **Tax Incentives**: State and local governments provide tax incentives to new, small and expanding businesses. Tax incentives reduce the tax burden on these companies.

   a. State and local governments rely upon a much broader group of taxes than does the Federal government. In addition to business income, they may tax a company's capital investment, property and sales.

   b. State and local tax incentives may take the form of tax credits, deductions, exemptions and abatements.

   c. State and local tax incentives are generally targeted on some form of investment. They may reduce the tax burden on business inventory, energy and fuel conservation, pollution control, property, research and development, the purchase of raw materials, machinery and equipment, and the creation of jobs.

   d. Some states grant tax relief to investors in seed and venture capital funds, particularly those that invest in targeted industries in the state.

4. **Enterprise Zones**: State enterprise zone programs designate neighborhoods within cities or rural communities to receive priority treatment from state finance programs, relief from certain regulatory requirements, and special tax incentives.

a. Businesses operating in enterprise zones, and their employees, are the recipients of enterprise zone support. Zone incentives reduce their costs of investment and operations.

b. The enactment of a Federal enterprise zone program will help empower community groups and businesses to establish companies that achieve profitable self-sufficiency.

5. **Information about specific business finance programs** can be obtained by contacting your state or local Department of Commerce or through your local Chamber of Commerce. The "Directory of Incentives for Business Investment and Development in the United States" is also available in most large public and university libraries.

VII. SUCCESS AND FAILURE FACTORS IN OBTAINING FINANCING

Business Questions for Section VII

What factors separate successful borrowers from companies that cannot raise the capital they need?

What critical information about your company must you be able to show a lender in order to receive your loan?

What are the problems with your company or your loan application that can cause a lender to turn you down?

How can you maintain a good relationship with your creditors?

A. Successful Borrowers:

Successful borrowers shop around among lenders to get the best deal for their company.

1. A company should pick the lender it applies to with care. Niche transportation companies should choose a lender that works with small businesses.

2. If a company has been turned down for a loan, it will usually be harder to get a loan from a second lender.

B. Successful applicants show the lender:

1. A track record of personal and business financial responsibility.

    a. For a new company, the financial history of the entrepreneur may be evaluated by the lender to help it determine the creditworthiness of the company.

    b. For an established company, the lender will evaluate its payment history on earlier loans. Has it been delinquent, i.e., late in its payments? Has it ever defaulted on a loan?

2. Financial statements, and/or projections, that show the financial condition of the company.

   a. Owners and managers should be able to discuss the company's financial ratios with the lender.

   b. When projections are used, a new company or a company seeking additional capital should make the assumptions used to create its projections reasonable, defensible and clear.

3. Demonstrated source(s) of repayment of the loan.

   a. For short-term financing, the company should be able to describe its credit policies and cash conversion cycle.

   b. For long-term financing, the earnings' history and projected sales and earnings of the company will be important considerations for the lender.

4. Business and financial plans.

5. The validity of the financing need.

   a. The lender will want to know specifically how the borrowed money will be used, and why it is important to the company.

   b. Owners and managers should be able to specifically relate the loan and its use to their business and financial plans.

   c. Request only the amount of money that the company actually needs. Lenders can get suspicious of companies that ask for too much money.

6. Acceptable bookkeeping, financial reporting and management control systems.

7. Available business and/or personal assets to secure the loan.

C. Why lenders turn down loan applications:

1. The owner's equity in the company is inadequate to provide a cushion for the lender.

   a. Inadequate equity may indicate that the company has too high a debt-to-equity ratio or that its coverage ratios are too low. Too high a debt-to-equity ratio is the most common reason lenders give for rejecting loan applications.

   b. Inadequate equity may also indicate that the owners have too little a stake in the business to maintain their commitment and motivation.

2. The company has a poor collections or earnings record, or the assumptions underlying its projections of cash conversion or earnings are unclear or unrealistic.

3. The company has not provided the lender with enough information to evaluate the loan request.

   a. Company owners and managers should call the lender to arrange an appointment and find out the information the lender requires when evaluating an application for a loan.

   b. Ordinarily, lenders will need to know the amount of loan requested, the desired maturity of the loan, the company's collateral and source(s) of repayment, how the borrowed funds will be used to meet the company's business and financial plan objectives, the company's financial statements and projections, and the entrepreneur's personal financial statements.

4. There is not enough security for the loan. Collateral may be inadequate or of insufficient quality.

5. The company's management team is not complete, does not have enough business expertise or advisors, such as a lawyer and an accountant, to provide guidance, or is not maintaining adequate business and financial controls over company operations.

6. The lender is not familiar with the company, its owners and managers and/or the transportation industry.

D. Maintain a good relationship with your lender:

1. Make your payments on time.

2. Disclose any cash flow problems before they reach the crisis stage.

3. Provide the lender with updated information about the business before it is requested.

   a. Treat your lender as an advisor. See him once in a while, even when the company does not need money or have a problem. Keep him involved.

   b. Inform the lender of new company undertakings before initiating them.

   c. Invite your lender to visit your company.

CHAPTER FOUR

FINANCING MODELS FOR REVERSE COMMUTING COMPANIES

I. INTRODUCTION TO FINANCIAL MODELS

The Purpose of this Chapter

In the previous Chapters of the *Financing Handbook*, niche transportation company entrepreneurs have been shown basic concepts relating to the successful financing of their start-up and expanding businesses. In this Chapter, the *Handbook* describes four model niche transportation companies.

These models are arranged to show four stages in the development of a single company. Or, they may be seen as different start-up opportunities, i.e., as different size companies at which the niche company entrepreneur may begin operations, depending upon the availability of investment capital and the size of the company's likely market for services.

Different combinations of public/private equity and debt financing that may be used for each of the four niche company models are outlined in a **Financial Strategies Matrix.**

Chapter Four also includes examples of income statements and balance sheets for the four model niche transportation companies. Niche company entrepreneurs may use these model financial statements to develop financial statements and projections for their own companies.

The model financial statements presented in this Chapter are based on the actual financial performance of successful niche companies. They should, however, be used with caution. They are only examples, and may not be directly applicable to your company. Costs and revenues will vary with the location and market conditions of different niche companies. For example, the costs of insuring your vans may vary widely with your location and the nature of the services you provide.

II. FINANCIAL STRATEGIES MATRIX

TYPES AND SOURCES OF FINANCING	MODEL I	MODEL II	MODEL III	MODEL IV
EQUITY				
Founding Entrepreneur				X
Government Grant	X	X	X	X
Foundation Grant	X	X		
Informal Investor				X
Seed Capital Fund				
Venture Capital Fund				
SBIC or MESBIC			X	
SHORT-TERM FINANCING				
Trade Credit				
Suppliers	X	X	X	X
Line of Credit				
Commercial Bank				X
Finance Company			X	
Commercial Loan				
Commercial Bank				
Finance Company				
Factoring Company				
Revolving Credit				
Commercial Bank				
Finance Bank				
Factoring Company				
Accounts Receivable Loan				
Commercial Bank			X	
Finance Company				X
Factoring Company		X		

TYPES AND SOURCES OF FINANCING	MODEL I	MODEL II	MODEL III	MODEL IV
LONG-TERM FINANCING				
Equipment Loan				
Commercial Bank			X	
Finance Company				
Equipment Seller				X
Foundation				
Real Estate Loan				
Commercial Bank				X
Foundation				
Financial Lease				
Equipment Manufacturer				
Leasing Company				X
Commercial Bank				
Finance Company				
Operating Lease				
Equipment Manufacturer			X	
Leasing Company		X		
Commercial Bank				
Finance Company				
GOVERNMENT FINANCING				
Federal Financing				
FTA ESP Grant	X	X	X	X
FTA 16(b) (2) Grant				
SBA 7(a) Loan Guarantee				X
SBA 504 CDC Loan				
HUD CDBG Loan	X			
JTPA	X	X	X	X
TJTC				X
State and Local Financing				
Loan		X		
Loan Guarantee			X	
Tax Incentives				X
Enterprise Zone				X

III. MODEL I: MINIMUM INITIAL CAPITAL INVESTMENT

A. *Company Description:*

1. Niche Transportation Company I is a non-profit, community owned and operated corporation.

2. It provides job training and placement services. It does not directly provide transportation services. These services are subcontracted to an existing private provider.

3. Company I does not require capital to buy vans or other capital equipment to begin operations. These capital costs are borne by the private provider of transportation services and are paid for by Company I with an hourly rental fee. Its working capital needs also include office rental and equipment, salaries and marketing expenses.

4. Financing sources for Company I include owners' equity, government and foundation grants, and trade credit.

B. Niche Transportation Company I: Income Statement

		Assumptions
REVENUE	65,625	150 MI./DAY @$1.75 MI.
OPERATING EXPENSES		
VEHICLE EXPENSE	44,000	2000 HRS./YR. @ $22/HR.
GEN. AND ADMIN. EXPENSES		
ADMIN. SALARY	25,000	OWNER/OPERATOR
COMMUNICATIONS	960	TWO PHONE LINES: $80/MO.
OFFICE EXPENSES	5,040	OFFICE RENT AND SUPPLIES @ $300/MO. COMPUTER, FAX MACHINE, FURNITURE & TELEPHONE LEASE @ $120/MO
GEN. LIAB. & PROP. INSURANCE	1,200	
TOTAL G & A EXPENSES	32,200	
TOTAL EXPENSES	76,200	
REVENUE LESS EXPENSES	(10,575)	
ESP GRANT	82,500	
FUND BALANCE, END OF YEAR	71,925	
NET PROFIT AS A % OF TOTAL REVENUE	-16.11%	

C. Niche Transportation Company I: Balance Sheet

ASSETS		
CASH	70,723	NET PROFITS, LESS A/R, PLUS A/P AND GRANT MONEY
ACCOUNTS RECEIVABLE	5,469	60 DAYS OF 1/2 OF MONTHLY REVENUE
TOTAL ASSETS	76,192	
LIABILITIES & FUND BALANCE		
LIABILITITES		
ACCOUNTS PAYABLE	4,267	ONE MONTH'S EXPENSES, LESS PAYROLL
FUND BALANCE	71,925	NET PROFITS PLUS GRANT
TOTAL LIABILITIES & FUND BALANCE	76,192	

IV. MODEL II: MODERATE START-UP (FIRST EXPANSION) CAPITALIZATION

A. Company Description:

1. Niche Company II is also a non-profit, community owned and operated corporation.

2. Company II provides job training and placement services. It also directly provides transportation services through the use of leased vehicles.

3. Financing needs for Company II do not include investment capital to purchase vehicles or to provide maintenance facilities for their repair. These capital costs are borne by the vehicle leasing company and are paid for by Company II through its lease payments. Additional working capital needs for Company II include office rental and equipment, salaries, marketing expenses and vehicle operating costs (e.g., insurance, gas, driver's salaries and benefits).

4. Financing sources for Company II include owners' equity, government and foundation grants, trade credit, line of credit, accounts receivable loans, and public/private loans.

B. Niche Transportation Company II: Income Statement

		Assumptions
REVENUE	273,000	150 MI./DAY @$1.75/MI.
OPERATING EXPENSES		
VEHICLE LEASES	24,000	4 VANS @$500/MO.
GAS & OIL	10,288	4 VEH. @3,300 MI./MO., @17 MI./GAL. @$1.10/GAL., PLUS 4 QUARTS OIL/MO.
REPAIRS & MAINTENANCE	16,800	$350 PER VEHICLE PER MONTH
VEHICLE INSURANCE	16,000	$4,000/YR. PER VEHICLE
DRIVERS' WAGES & P/R TAXES	112,320	6 @$9/HR. FOR 2080 HRS./YR.
DRIVERS' WORKERS COMP.	10,109	10% OF WAGES (10% OF 90% OF ABOVE)
TOTAL OPERATING EXPENSES	189,517	
GEN. & ADMIN. EXPENSES		
ADMIN. SALARIES & P/R TAXES	55,000	OWNER/OPERATOR AND DISPATCHER
COMMUNICATIONS	1,200	TWO PHONE LINES: $100/MO.
EMPLOYEE BENEFITS	14,400	HEALTH INS. @$150/MO. FOR 8 PEOPLE
OFFICE EXPENSE	6,420	OFFICE RENT AND SUPPLIES @$400/MO. COMPUTER, FAX MACHINE, FURNITURE & TELEPHONE LEASE @$135/MO.
GEN. LIAB. & PROP. INSURANCE	3,000	
TOTAL G & A EXPENSES	80,000	
TOTAL EXPENSES	269,537	
REVENUE LESS EXPENSES	3,463	
ESP GRANT	150,000	
FUND BALANCE, END OF YEAR	153,463	
NET PROFIT AS A % OF TOTAL REVENUE	1.27%	

C. Niche Transportation Company II: Balance Sheet

ASSETS		
CASH	139,231	NET PROFITS, LESS A/R, PLUS A/P AND GRANT MONEY
ACCOUNTS RECEIVABLE	22,750	60 DAYS OF 1/2 OF MONTHLY REVENUE
TOTAL ASSETS	161,981	
LIABILITIES & FUND BALANCE		
LIABILITIES		
ACCOUNTS PAYABLE	8,518	ONE MONTH'S EXPENSES, LESS PAYROLL
FUND BALANCE	153,463	NET PROFITS PLUS GRANT
TOTAL LIABILITIES & FUND BALANCE	161,981	

V. MODEL III: LARGE INITIAL (SECOND EXPANSION) CAPITALIZATION

A. Company Description:

1. Niche Company III is a for-profit, community owned and operated corporation.

2. Company III provides job training and placement services. It also directly provides transportation services through the use of purchased vehicles.

3. Company III's financing needs include capital to purchase its vehicles. Vehicle maintenance is subcontracted. In addition to working capital to pay maintenance costs, the Company also needs cash to pay for office rental and equipment, salaries, marketing expenses and vehicle operating costs.

4. Financing sources for Niche Company III include owners' equity, retained earnings, government and foundation grants, trade credit, line of credit, accounts receivable loans, equipment loans, public/private loans and loan guarantees.

B. Niche Transportation Company III: Income Statement

		Assumptions
REVENUE	682,500	150 MI./DAY @$1.75/MI.
OPERATING EXPENSES		
VEHICLE LOAN INTEREST	5,000	10 VEHICLES @$500/YR.
GAS & OIL	25,720	10 VEH. @3,300 MI./MO., @17 MI./GAL. @$1.10/GAL., PLUS 10 QTS. OIL/MO.
REPAIRS & MAINTENANCE	48,000	$400 PER VEHICLE PER MONTH
VEHICLE INSURANCE	40,000	$4,000/YR. PER VEHICLE
DEPRECIATION	45,000	$4,500/VEHICLE/YR.
DRIVERS' WAGES & P/R TAXES	280,800	15 @$9/HR. FOR 2080 HRS./YR.
DRIVERS' WORKERS COMP.	25,272	10% OF WAGES (10% OF 90% OF ABOVE)
TOTAL OPERATING EXPENSES	469,792	
GEN. & ADMIN. EXPENSES		
ADMIN. SALARIES & P/R TAXES	134,200	OWNER/OPERATOR, TWO DISPATCHERS, BOOKKEEPER & MKTG. ASST.
COMMUNICATIONS	1,800	THREE PHONE LINES: $150/MO.
EMPLOYEE BENEFITS	28,800	HEALTH INS. @$150/MO. FOR 16 PEOPLE
LEGAL & ACCOUNTING	2,500	
OFFICE EXPENSE	11,040	OFFICE RENT AND SUPPLIES @$700/MO. COMPUTER, FAX MACHINE, FURNITURE & TELEPHONE LEASE @$220/MO.
GEN. LIAB. & PROP. INSURANCE	5,000	
TOTAL G & A EXPENSES	183,340	
TOTAL EXPENSES	653,132	
NET PROFIT BEFORE TAXES	29,368	
PROVISION FOR TAXES		
FEDERAL	4,405	15%
STATE	1,762	6%
TOTAL TAXES	6,167	
NET PROFIT AFTER TAXES	23,201	
NET PROFIT AFTER TAXES AS A PERCENT OF TOTAL REVENUE	3.40%	

C. Niche Transportation Company III: Balance Sheet

ASSETS		
CURRENT ASSETS		
CASH	44,705	
ACCOUNTS RECEIVABLE	56,875	60 DAYS OF 1/2 MONTHLY REVENUE
TOTAL CURRENT ASSETS	101,580	
FIXED ASSETS		
FURNITURE & FIXTURES	25,000	
RADIO EQUIPMENT	12,000	
VEHICLES	150,000	
	187,000	
LESS: ACCUM. DEPRECIATION	(93,500)	
NET FIXED ASSETS	93,500	
TOTAL ASSETS	195,080	
LIABILITIES & STOCKHOLDERS' EQUITY		
LIABILITIES		
CURRENT LIABILITIES		
ACCOUNTS PAYABLE	19,844	ONE MONTH'S EXPENSES, LESS PAYROLL
NOTES PAYABLE - VEHICLES	58,080	LOANS ON TEN VEHICLES @$484/MO. EA. ($15,000/VAN @10% FOR 36 MOS.)
TOTAL CURRENT LIABILITIES	77,924	
OTHER LIABILITIES		
LONG-TERM NOTES PAYABLE	29,040	
TOTAL LIABILITIES	106,964	
STOCKHOLDERS' EQUITY		
COMMON STOCK	10	
RETAINED EARNINGS	88,105	
TOTAL STOCKHOLDERS' EQUITY	88,115	
TOTAL LIAB. & STOCKHOLDERS' EQUITY	195,080	

VI. MODEL IV: MAXIMUM INITIAL (FULL EXPANSION) CAPITALIZATION.

A. Company Description:

1. Niche Company IV is a for-profit, community-owned and operated corporation.

2. Its services include job training and placement as well as transportation services that use vehicles it has purchased. Company IV also owns its maintenance facilities and directly services its vehicles.

3. Financing needs for Company IV include capital to purchase its vehicles and maintenance facilities. Working capital to cover office rental and equipment, salaries, marketing and vehicle operating and maintenance costs will also be required.

4. Financing sources include owners' equity, retained earnings, government and foundation grants, seed capital, trade credit, line of credit, revolving loans, accounts receivable loans, real estate loans, equipment loans, public/private loans and loan guarantees.

B. Niche Transportation Company IV: Income Statement

		Assumptions
REVENUE	1,365,000	150 MI./DAY PER VEHICLE @$1.75/MI.
OPERATING EXPENSES		
VEHICLE LOAN INTEREST	10,000	20 VEHICLES @$500/YR.
GAS & OIL	51,247	20 VEH. @3,300 MI./MO., @17 MI./GAL.
REPAIRS & MAINTENANCE	84,000	$350 PER VEHICLE PER MONTH
VEHICLE INSURANCE	80,000	$4,000/YR. PER VEHICLE
DEPRECIATION	90,000	$4,500/VEHICLE/YR.
DRIVERS' WAGES & P/R TAXES	561,600	30 @$9/HR. FOR 2080 HRS./YR.
DRIVERS' WORKERS COMP.	50,544	10% OF WAGES (10% OF 90% OF ABOVE)
GARAGE EXPENSE	36,000	ONE MECHANIC, GARAGE RENT @$500/MO.
TOTAL OPERATING EXPENSES	963,391	
GEN. & ADMIN. EXPENSES		
ADMIN. SALARIES & P/R TAXES	192,500	OWNER/OPER., 2 DISPATCHERS, 1 OPERATIONS COORD., 1 BKKPR.,1 CLERK, 1 MKTG. PERSON
COMMUNICATIONS	3,000	FIVE PHONE LINES: $250/MO.
EMPLOYEE BENEFITS	66,600	HEALTH INS. @$150/MO. FOR 37 PEOPLE
LEGAL & ACCOUNTING	5,000	
OFFICE EXPENSE	12,120	@$1,010/MO.
OFFICE RENT & UTILITIES	20,400	@$1,700/MO.
GEN. LIAB. & PROP. INSURANCE	7,500	
TOTAL G & A EXPENSES	307,120	
TOTAL EXPENSES	1,270,511	
NET PROFIT BEFORE TAXES	94,489	
PROVISION FOR TAXES		
FEDERAL	20,376	15% OF 1ST $50,000, 25% OF NEXT $25,000, 34% OF REMAINDER
STATE	5,669	6%
TOTAL TAXES	26,046	
NET PROFIT AFTER TAXES	68,443	
NET PROFIT AFTER TAXES AS A PERCENT OF TOTAL REVENUE	5.01%	

C. Niche Transportation Company IV: Balance Sheet

ASSETS		
CURRENT ASSETS		
CASH	68,746	
ACCOUNTS RECEIVABLE	113,750	60 DAYS OF 1/2 MONTHLY REVENUE
INVENTORY - PARTS	5,000	
TOTAL CURRENT ASSETS	187,496	
FIXED ASSETS		
FURNITURE & FIXTURES	35,000	
RADIO EQUIPMENT	22,000	
VEHICLES	300,000	
MAINTENANCE EQUIPMENT	3,500	
	360,500	
LESS: ACCUM. DEPRECIATION	(206,000)	
NET FIXED ASSETS	154,500	
TOTAL ASSETS	547,996	
LIABILITIES & STOCKHOLDERS' EQUITY		
LIABILITIES		
CURRENT LIABILITIES		
ACCOUNTS PAYABLE	43,034	ONE MONTH'S EXPENSES, LESS PAYROLL
NOTES PAYABLE - VEHICLES	116,160	$484/MO. PER VAN: 20 @$15,000 EA. @10% FOR 36 MOS.
TOTAL CURRENT LIABILITIES	159,194	
OTHER LIABILITIES		
NOTES PAYABLE, LESS CURRENT PORTION	58,080	
TOTAL LIABILITIES	217,274	
STOCKHOLDERS' EQUITY		
COMMON STOCK	10	
RETAINED EARNINGS	330,711	
TOTAL STOCKHOLDERS' EQUITY	330,721	
TOTAL LIAB. & STOCKHOLDERS' EQUITY	547,996	

GLOSSARY OF FINANCIAL TERMS

<u>Accounts Payable</u> are amounts of money owed by a company to its suppliers of goods and services received but not yet paid for. See, Trade Credit.

<u>Accounts Receivable</u> are amounts of money owed to a company by its customers for goods or services delivered but not yet paid for.

<u>Accounts Receivable Loans</u> are a form of short-term loan to a company where the collateral for the loan is the company's future collections from sales to its customers.

<u>Accrued But Unpaid Interest</u> is accumulated interest a borrower owes to a lender on a loan which is due but not yet paid.

<u>Accrued Expenses</u> are liabilities for services received for which payment has not yet been made. The most common accrued expenses are wages and taxes.

<u>Activity Ratios</u> measure how effectively a company uses its resources, such as accounts receivable.

<u>Amortization</u> is the reduction of a debt by regular payments of principal and interest. See, Debt Service Payments.

<u>Appraised Value</u> is the value of property determined by an independent, professional evaluation as part of an application for a loan. See, Loan-to-Value Ratio.

<u>Assets</u> are anything owned by a business that has value. Examples of assets include land, buildings, equipment, inventory, bank accounts and accounts receivable. See, Liabilities and Equity.

<u>Associations</u> are business organizations that share the characteristics of both corporations and partnerships. An association may be taxed either as a corporation or a partnership. See, Corporations and Partnerships.

<u>Average Collection Period</u>: accounts receivable divided by annual credit sales as divided by 360.

Balance Sheet is a financial statement showing the condition of a company's assets, liabilities and equity on a given date. It is a snap-shot of a company's financial condition. See, Fiscal Year, Income Statement and Statement of Cash Flow.

Balloon Payment Loans are loans where the regular debt service payments will not fully repay the loan. At maturity, the borrower will make a large final payment, known as the balloon payment, that fully repays the lender. See, Self-Amortizing Loans.

Bankruptcy, or insolvency, is the inability of a company to pay its bills. Bankrupt companies may be dissolved or reorganized under Federal bankruptcy law.

Base Period is a period of time in the past used as a yardstick from which financial projections are made. See, Growth Rate.

Benchmarks are steps in a company's development. They break down its long-term business goals and place them on a performance timetable that enables owners, managers and lenders to measure how well they are being met.

Board of Directors is a group of individuals elected by the shareholders of a corporation to represent them and to carry out certain tasks such as appointing senior management, issuing new shares and declaring dividends.

Borrower is an individual or company that receives a loan and is responsible for its repayment. See, Lender and Creditors.

Breakeven Analysis identifies the level of sales a company needs to achieve to achieve profitability.

Breakeven Point is the level of sales where total costs equal total revenues.

Business Cycle is the series of expansions (recoveries) and contractions (recessions) that the economy moves through over time.

Cancellation Penalty is an additional cost paid for ending a lease or other contract before it has expired. Borrowers are frequently required by their loan agreements to pay a prepayment, or cancellation, penalty when they repay the loan before maturity.

Capital Budget is a plan for financing long-term investments such as purchases of vehicles or real estate. See, Net Cash Flow, Payback Period and Net Present Value.

Capital Expenditure is the investment of money to acquire or improve long-term assets.

Capital Gains is the difference between the purchase price of an asset and its higher selling price. A capital loss occurs when the selling price is lower than the purchase price.

Cash Collection Cycle begins when a company creates accounts payable by acquiring the assets it needs to operate its business. With sales and service delivery, the company creates accounts receivable. The cash collection cycle ends when these accounts receivable are collected as cash by the company. See, Service Delivery Cycle.

Cash Discount is a reduction in the price of goods or services purchased by a company that has been granted by their supplier for prompt payment. See, Trade Credit.

Cash Flow is the amount of money coming into and going out from a company during a particular time period. When more cash comes in than goes out, the company has a positive cash flow. When more money goes out than comes in, the company has a negative cash flow. Companies can go bankrupt when they cannot generate enough cash to pay their current bills. See, Cash Conversion Cycle and Service Delivery Cycle.

Cash Flow Forecast is a one year projection of the amount of money that will be coming into and going out from a company.

Clean-Up Period is a period of time during the year, usually one month, when no borrowing occurs under a credit line or revolving loan, and the loan has been fully repaid.

C.O.D., or cash on delivery, is a requirement that goods or services being purchased be paid for in full at the time they are delivered. See, Trade Credit.

Collateral is an asset pledged by a borrower to a lender until a loan is repaid. If the borrower fails to repay, the lender has the legal right to seize the asset and sell it to pay off the loan. See, Default, Lien, Deed of Trust, Mortgage and Security.

Collection is turning accounts receivable into cash. It is the actual receipt of cash from customers for goods or services purchased. See, Cash Conversion Cycle and Service Delivery Cycle.

Commercial Banks are private financial institutions that receive deposits and make consumer loans, short- and long-term business loans, and mortgages on residential and business properties.

Commercial Finance Companies are private financial companies that make consumer loans and short-term business loans. They do not take deposits but, rather, raise the funds they lend by selling securities to investors and borrowing from commercial banks.

Commitment Fee is a charge by a lender for holding money available for a borrower. The term points has the same meaning as commitment fee.

Compensating Balance is the average amount of money a borrower must maintain on deposit with a lender as security for a loan or for holding money available for the borrower.

Corporations are business organizations owned by stockholders and run by a board of directors and hired management. Corporations pay income taxes on their profits. Profits distributed to stockholders as dividends are separately taxed. See Partnerships and Associations.

Coverage Ratios describe the relationship between a company's interest payments and its capacity to pay them. They are indicators of creditworthiness.

Credit History is a loan applicant's record of paying its bills on time.

Creditors are people or businesses to which a borrower owes money. Lenders are creditors. Suppliers of goods and services to a company who have not yet been paid are also creditors.

Credit Period is the period of time during which a company owes money to its suppliers for the purchase of goods and services. See, Trade Credit.

Credit Policy is the terms and conditions for trade credit offered by a company to its customers.

Credit Rating is a formal evaluation of an individual's or company's credit history and ability to repay its debts. Dunn & Bradstreet (D&B) is the largest company that investigates, analyzes and maintains records on business credit ratings. See, Creditworthiness.

Credit Review is the lender's evaluation of a company's ability to repay a loan. It is part of the loan application process.

Credit Standards are the criteria used conduct a credit review. Credit standards will be different for different lenders. They may include an analysis of the company's credit history, equity, financial ratios, source of repayment, collateral and need for the borrowed money. For small companies, the personal assets and credit history of the company's principal owners and managers may also be credit standards used to evaluate the company's ability to repay the loan. See, Risk Factors.

Credit Terms with a company's suppliers state the conditions of trade credit. They include the credit period, the size of the cash discount, the cash discount period, and the date the credit period begins.

Creditworthiness is the ability of a company to repay its loans. Companies with good creditworthiness can borrow money at lower interest rates. Companies with poor creditworthiness may not be able to borrow money even at higher interest rates. See, Credit Rating and Risk Factors.

Current Assets are cash, accounts receivable, inventory and other things of value owned by a company that are likely to be sold or otherwise converted into cash within the normal course of one year of business. See, Current Liabilities.

Current Liabilities are the debts and other expenses of a company, such as accounts payable and taxes payable, which will come due for payment within a year. See, Current Assets, Liabilities and Long-Term Liabilities.

Current Ratio: current assets divided by current liabilities.

Debt is money borrowed from suppliers, private financial institutions or public/private development agencies. Debt agreements obligate the borrower to repay its lender with interest. Debts are classified as short-term if they will be repaid within one year and long-term if repayment will take more than a year. See, Loan.

Debt Service Payments are the regular, periodic (monthly, quarterly) payments of principal and interest made by a borrower to a lender in repayment of a loan.

Debt, or Cash Flow, Coverage Ratio: cash flow minus interest and taxes divided by interest and principal payments on long-term debt.

Debt or Leverage Ratios measure the relative amounts of debt and equity in the financial structure of a company, and its capacity to meet its long-term debts. They indicate creditworthiness.

Debt-to-Assets Ratio: total company liabilities divided by total company assets.

Deed of Trust is an agreement by which a borrower gives a lender a lien on its property to serve as collateral for the repayment of a loan. The borrower continues to use the property and the lien is removed when the loan is repaid. If the borrower defaults, the lender may rely upon the deed of trust to acquire the property and sell it to repay the loan. See, Lien and Mortgage.

Default is the failure of a borrower to make timely payments of principal and interest on a loan as they come due or to otherwise fail to comply with specific terms and conditions of the loan agreement. When a borrower defaults, the lender may sell the collateral to repay the loan. See, Delinquent, Debt Service Payments, Lien, Deed of Trust and Mortgage.

Delinquent borrowers are late in their debt service payments. If a loan remains delinquent for too long, the lender may treat the failure to repay as a default.

Depreciation distributes the cost of an asset over its useful life. For example, the depreciation of a vehicle that cost $20,000 and has a useful life of 2 years would be $10,000 per year.

Disbursements are payments for expenses. They include payments for vehicle operating costs, wages and employee benefits, rent, marketing and administrative costs, and debt service payments. See, Expenditures and Revenue.

Discount is a reduction in the selling price of goods or services in return for quick payment by the purchaser. See, Trade Credit.

Discount Rate is the interest rate used in net present value analysis to determine the present value of future cash flows.

Dividends are distributions of a corporation's earnings to its shareholders, usually in the form of cash payments or additional shares of stock in the corporation. Dividends must be declared as taxable income by the shareholders in the year in which they are received. See, Retained Earnings.

Earnings are a company's net profits, i.e., profits after taxes have been paid. See, Retained Earnings.

Earnings History is the record of a company's net profits.

Enterprise Zone programs choose neighborhoods in cities or rural areas to receive priority treatment from government-supported business and community development finance programs, relief from certain regulatory requirements, and special tax incentives.

Entrepreneur is a person who takes on the risks of starting a new business. The founder of a company is an entrepreneur.

Equipment Loan is a term loan secured by the equipment it is used to purchase.

Equity is the owners' investment in a company. Equity owners share the risk that the company will be profitable. There is no interest rate or obligation to repay equity investors. See, Sweat Equity, Entrepreneur and Debt.

Expansion Capital is the investment dollars needed to grow an existing company. For example, expansion capital may be used to acquire the assets needed to open new markets or establish new services. See, Start-Up Capital, Internally Generated Funds, Retained Earnings, Informal Investors, SBICs and MESBICs, and Venture and Seed Capital Funds.

Expenditures are payments of money by a company. They include disbursements and capital investments. See, Revenue.

Factoring is the sale of a company's accounts receivable to a factoring company which is then responsible for their collection. The factoring company buys the accounts receivable without recourse, i.e., it cannot turn to the company for reimbursement if its cannot collect the amount owed from the customer.

Factoring Company is a private financial company that purchases accounts receivable.

Financial Analysis lets the owners and managers of a company, and its lenders, know how well the company is being run. The basic methods of financial analysis include trend analysis of financial statement data, ratio analysis, and breakeven analysis.

Financial Leases are a type of rental agreement in which the lessor finances the use of equipment by the lessee who is responsible for its possession and use. See, Operating Leases.

Financial Planning is a process for projecting the future performance and financial needs of a company.

Financial Statements are the written records of the financial position of a company. They include a company's balance sheets, income statements and statements of cash flow.

Fiscal Year is an accounting period covering 12 consecutive months at the end of which a company's books are closed, its annual financial statements finalized and its profits or losses determined. A company's fiscal year is often a calendar year.

Fixed Assets are property used in the operation of a company that are not expected to be consumed or sold within the ordinary course of business. Fixed assets include land, buildings and equipment such as vehicles. See, Current Assets.

Fixed Costs are those costs which do not vary with the amount of service delivered, i.e., the number of rides delivered or vehicles used. Also called indirect costs, they typically include management salaries, rent, utilities, long-term debt service and business insurance. See, Variable Costs.

Fixed Rate Loans are loans with an interest rate set at the time the loan is made. The interest rate on fixed rate loans will not change during the time that the loan is being repaid. See, Variable Rate Loans.

For-Profit corporations, partnerships and associations pay taxes. See, Non-Profit.

Full-Service Leases are a type of operating lease in which maintenance is provided by the lessor and paid for through a company's rental payments. See, Operating Leases and Partial-Service Leases.

General Partner is any owner of a company doing business as a partnership. In a limited partnership, the general partner is an owner and the managing partner. A general partner has unlimited liability for the debts of the partnership. See, Limited Partner.

Gross Margin, or gross profit, equals sales minus the cost of goods sold.

Gross Sales equals total sales.

Growth Rate is the speed at which a company is projected to increase (or decrease) in size in the future. Historical data is used to determine a realistic growth rate. See, Base Period.

Hurdle Rate is used in net present value analysis to describe the minimum rate of return on a proposed investment that a company requires in order to consider that investment financially acceptable.

Income Statement is a summary of a company's revenues, costs and expenses during an accounting period. It is also called a profit and loss statement. See, Fiscal Year, Balance Sheet and Statement of Cash Flow.

Inflation is the rise in prices that occurs when the money supply increases more rapidly than the supply of goods and services, i.e., when too much money is chasing too few goods and services.

Informal Investors include an entrepreneur's family, friends and colleagues. They may also include wealthy individuals such as other successful entrepreneurs, business people and business development professionals who make equity investments in emerging companies. See, Expansion Capital, Start-Up Capital, SBICs and MESBICs, and Venture and Seed Capital Funds.

Insurance is a system through which individuals and companies, concerned about potential hazards such as vehicle accidents, pay money, or insurance premiums, to an insurance company that agrees to reimburse them if they suffer losses from the occurrence of that hazard. Insurance spreads the risk of loss.

Interest Rates are the charges a lender will require from a borrower for a loan. Interest is the cost of money. See, Principal and Debt Service Payments.

Internally Generated Funds are the capital resources created by the operation of a company and reinvested in the company to finance its growth. Additional equity investment and retained earnings are sources of internal capital for small companies.

Inventory is the value of a company's materials and supplies used in its operations. For example, inventory would include the value of spare parts a transportation company keeps on hand to repair its vehicles.

Lease is a contract granting the possession and use of real estate or equipment for a specified period of time in exchange for the payment of rent.

Leasing Company is a private finance company that owns property and leases it to the individuals or companies in return for the payment of rent.

Lenders are individuals, private financial institutions and government-supported agencies that loan money to a borrower who repays the loan, usually with interest. See, Borrower.

Lessee is the user of leased property who makes rental payments to the lessor.

Lessor is the owner of leased property to whom the lessee makes rental payments.

Liabilities are amounts of money that must be paid by a company at some future date. Liabilities include debts, accounts payable to suppliers and accrued expenses such as salary and benefits owed to employees. See, Assets, Equity, Current Liabilities and Long-Term Liabilities.

Lien is a legal claim against the property of an individual or company that serves as collateral for the repayment of a loan. If the loan is unpaid, the lienholder may use the lien to acquire the property and sell it in repayment of the debt. See, Default, Deed of Trust and Mortgage.

Limited Partner is an owner of a partnership who has limited liability for the debts of the partnership but does not actively participate in the management of the partnership's business. See. General Partner.

Line of Credit is a short-term loan in which a lender loans a company funds, as needed and at company request, up to the maximum dollar amount specified in the loan agreement. The loan is repaid as the company receives cash from collections on its sales.

Liquidity is the ability of a company to turn its assets into cash easily and without significant losses. High liquidity means that a company will be able to meet its debts promptly, earn trade discounts, benefit from a good credit rating and take advantage of market opportunities.

Liquidity Ratio: cash flow from operations divided by daily cash operating costs.

Liquidity Ratios measure the capacity of a company to meet its short-term obligations.

Loan is a business transaction in which the owner of property, frequently money, allows a borrower to use it. The borrower promises to return the property after a specified period of time and to pay for its use, frequently through interest payments. See, Debt.

Loan Guarantees are the assumption of responsibility to repay a loan when the borrower defaults. Federal, state and local government agencies, and some private insurance companies, provide loan guarantees to eligible companies to assist them in obtaining private financing. If the company defaults, they may acquire and sell the collateral to be reimbursed. See, Personal Guarantees.

Loan-to-Value Ratio is the relationship between the amount of money loaned and the appraised value of the property serving as collateral for the loan. For example, a loan-to-value ratio of 75% on a vehicle with an appraised value of $20,000 will result in a loan of $15,000 toward the purchase of the vehicle.

Long-Term Debts includes loans with maturities longer than one year. See, Short-Term Debts.

Long-Term Liabilities are liabilities, ordinarily loans, which will be repaid over more than a year. See, Liabilities and Current Liabilities.

<u>Loss</u> is the result of the operation of a company during an accounting period in which expenditures are more than revenues. See, Profit, and Net Profit or Net Loss.

<u>Matching Private Sector Investment</u> is a requirement of government-supported business financing programs that the company receiving the loan or other investment has also made an investment in the asset or activity funded by the government.

<u>Maturity</u> of a loan is the length of time for which the money is borrowed.

<u>Mortgage</u> is an agreement by which a borrower gives a lender a lien on its property to serve as security or collateral for the repayment of a loan. The borrower continues to use the property and the lien is removed when the loan is repaid. If the borrower defaults, the lender may rely upon the mortgage to acquire the property and sell it to repay the loan. See, Lien and Deed of Trust.

<u>Near-Cash Assets</u> are assets which a company may easily turn into cash, ordinarily through their sale.

<u>Net Cash Flow</u> analysis is a method of capital budgeting used to determine if a company will get more cash back from an investment than it spends? See, Net Present Value and Payback Period.

<u>Net Present Value</u> is a method of capital budgeting that compares a potential investment with alternative, available investments to determine whether the potential investment is financially acceptable. See, Net Cash Flow and Payback Period.

<u>**Net Profit Margin:**</u> net income after taxes divided by annual sales.

<u>Net Profit or Net Loss</u> is a company's bottom line. It is the difference between a company's total sales and its total costs and expenses. If total sales are larger than total costs and expenses, the company has a net profit. If total costs and expenses exceed total sales, a net loss has occurred. Net income and net earnings are terms used that have the same meaning as net profit. See Profit, Loss and Retained Earnings.

<u>**Net Working Capital Turnover Ratio:**</u> sales revenues divided by net working capital.

<u>Net Worth</u> is the amount of money by which assets are greater than liabilities. For businesses, shareholder's equity and net assets are terms with the same meaning as net worth. See, Equity.

<u>Non-Profit</u> corporations and associations, but not partnerships, may not have to pay taxes if they meet the standards for tax-exempt organizations specified by the Internal Revenue Service. See, For-Profit.

<u>Notes,</u> or obligations, are written promises to repay a loan.

Operating Income is the difference between the revenues of a company and its costs and expenses from its regular business activities. Other sources of revenue are not included in operating income. Interest, taxes and dividends are not costs and expenses included in operating income.

Operating Leases are a type of rental agreement in which a lessor grants a lessee the right to use the property being leased, ordinarily equipment, for a period of time less than the useful life of the property. The lessee's total rental payments cover only a portion of the property's value. The lessor remains responsible for some or all of the property's maintenance. See, Financial Leases.

Partial-Service Leases are operating leases in which some of the property's maintenance responsibilities are borne by the lessee. See, Full-Service Leases.

Partnerships are business organizations with two or more owners, or partners, agree to conduct joint business activities and share in the profits and losses of the business. At least one partner must be a general partner. Partnerships are not themselves taxed. Each partner's share of business income, expenses and losses is reported on his or her individual income tax return. There is no double taxation of partnership profits. See, Corporations and Associations.

Payback Period, or simple payback, is a method of capital budgeting used to determine how much time will it take a company to recover its investment in an asset. See, Net Cash Flow and Net Present Value.

Percentage of Expected Sales is a method of projecting future needs for assets. It is based on the assumption that there is a direct relationship between the amount of sales and the amount of assets needed to service them. For example, vehicle needs are directly related to growth in ridership.

Permanent Working Capital is the total amount of cash a company needs from the beginning to the end of the service delivery, or cash conversion, cycle. See, Working Capital.

Personal Guarantees are loan guarantees by individuals, ordinarily a company's major owners and senior managers, that they will repay a loan to the company in the event that it fails to repay.

Present Value is the value today of a future payment or stream of payments discounted at an appropriate discount rate. For example, the present value of $100 to be received 10 years from now is $38.55 using a discount rate of 10% compounded annually. In other words, $38.55 deposited today at 10% interest compounded annually would be worth $100 in 10 years. See, Net Present Value.

Prime Rate is the interest rate that commercial banks charge on loans to their most creditworthy customers. Less creditworthy customers, including most small businesses, will ordinarily pay a higher interest rate for their loans.

Principal is the amount of money borrowed in a loan that must be repaid with interest. Debt service payments ordinarily include a return of principal to the lender plus an interest payment.

Private Financial Institutions include commercial banks, savings and loans, savings banks, commercial finance companies, credit unions, leasing companies, factoring companies, mutual funds, insurance companies and pension funds. See, Public/Private Development Agencies.

Profit is the result of the operation of a company during an accounting period in which revenues are more than expenditures. See, Loss, Net Profit or Net Loss, and Retained Earnings.

Profitability Ratios measure the entrepreneur's success in operating his or her company.

Projected Financial Statements include balance sheets, income statements and statements of cash flow adjusted to reflect anticipated future events. They permit a company to determine its future financing needs and measure how well it is meeting its goals and performance benchmarks.

Public/Private Development Agencies provide loans, loan guarantees, and other forms of financial, technical and managerial assistance to companies that are eligible for government-supported assistance. See, Private Financial Institutions.

Quick, or Acid-Test, Ratio: current assets minus inventory divided by current liabilities.

Ratio Analysis is a tool of financial analysis that is used by business owners and managers and their investors and lenders to evaluate a company's performance.

Real Estate Loan is a term loan secured by the land and/or buildings it is used to purchase.

Refinance is an increase in the amount borrowed under an existing loan, the extension of the maturity date of a loan, a revision in the repayment schedule of a loan, or the use of a new loan to repay old debt.

Repayment of the principal and interest on a loan, or loan amortization, may take several forms. The two most common forms of loan repayment are self-amortization and balloon payment. See, Debt Service Payments.

Repossess is to regain the physical possession of an asset, ordinarily for failure to repay a loan or to make timely rental payments. A lender, for example, may repossess a vehicle when its borrower is in default. See, Lien.

Retained Earnings are the net profits of a business accumulated over time and kept in the company. Net profits may also be distributed to stockholders as dividends. Retained earnings are an important source of internally generated funds used to finance the expansion of a business. Undistributed profits and earned surplus are two other terms with the same meaning as retained earnings. See, Earnings and Internally Generated Funds.

Return on Investment: net profits after taxes divided by total assets.

Revenue equals total income from sales. See, Expenditures and Disbursements.

Revolving Credit is a form of short-term loan in which the business borrows and repays the loan several times during the revolving period. A maximum dollar amount that may be borrowed is specified in the loan agreement.

Risk Factors measure the possibility that a borrower will not repay a loan. They may include a weak credit history, inadequate equity, financial ratios below industry norms or showing negative trends, new product or service risk, and inadequate collateral. Lenders may also be concerned with inflation risk and interest rate risk. See, Creditworthiness, Credit Standards and Credit Rating.

SBICs and MESBICs are privately owned and operated venture capital funds sponsored by SBA that make equity and long-term debt investments in new, small companies. SBICs and MESBICs receive substantial financial assistance from SBA. See, Expansion Capital, Start-Up Capital, Informal Investors, and Venture and Seed Capital Funds.

Security is the collateral offered by a borrower to a lender to assure repayment of a loan. If it is not repaid, the lender may seize the collateral and sell it to repay the loan.

Self-Amortizing Loans are loans where the regular debt service payments fully repay the loan by maturity. See, Balloon Payment Loans.

Service Delivery Cycle begins when a company creates accounts payable by acquiring the assets it needs to operate its business. With sales and service delivery, the company creates accounts receivable. The service delivery cycle ends when these accounts receivable are collected as cash by the company. See, Cash Collection Cycle.

Short-Term Debts are loans with maturities of less than one year. They include trade credit, lines of credit, commercial loans, revolving credit, and accounts receivable loans. See, Long-Term Debts.

Standard Industrial Classification, or SIC, Code is a numbering system created by the Federal government to identify companies by industry. SIC Code 4111 best describes niche transportation companies.

Start-Up Capital is the money used to start and grow a company, to acquire first assets and working capital. Start-up capital may be generated internally by a company, or raised from outside sources. See, Expansion Capital, Internally Generated Funds, Retained Earnings, Informal Investors, SBICs and MESBICs, and Venture and Seed Capital Funds.

Statements of Cash Flow, or statement of changes in financial condition, focus on how sales create cash and how the company uses that cash to pay expenses. It describes changes in a company's working capital and financing that affect its supply of cash. See, Fiscal Year, Balance Sheet and Income Statement.

Stockholders, or shareholders, are the equity owners of a corporation.

Subchapter S Corporations are a special type of corporation that is only taxed once, on its stockholder's income tax return. Niche transportation companies may qualify as Subchapter S corporations.

Subsidized Interest Rates are the charges a public/private development agency will require from a borrower for a loan. They are lower than the interest rate charged by private lenders. The subsidy, or interest rate reduction, is paid by the agency.

Sweat Equity is the ideas, time and energy, but not the money, an entrepreneur invests in a new company. See, Equity.

Tax Abatement is a reduction in the taxes a company must pay. For example, cities may reduce the property taxes a company must pay as an incentive to stimulate new real estate development. See, Tax Incentives.

Tax Credit is a direct reduction in the tax bill of an individual or company on a dollar-for-dollar basis. Unlike tax deductions and exemptions which reduce taxable income, the dollar amount of the benefit of tax credits do not depend upon the tax bracket of the taxpayer. For example, a tax deduction or exemption of $1000 to a taxpayer in the 28% tax bracket is only worth $280. A tax credit of $1000 is worth $1000 to the same taxpayer. See, Tax Incentives.

Tax Deductions are business expenses allowed by the Internal Revenue Service as a subtraction from gross income in arriving at a company's taxable income. See, Tax Incentives.

Tax Exemptions are types of business income allowed by the IRS to be excluded from gross income when determining a company's taxable income. See, Tax Incentives.

Tax Incentives are abatements, credits, deductions and exemptions that reduce the tax burden on individuals and companies. Governments provide tax incentives for particular activities they wish to encourage. For example, the Targeted Jobs Tax Credit (TJTC) is designed to stimulate the employment of low- and moderate-income individuals.

Term Loans are long-term secured loans provided to a company to finance capital equipment and permanent working capital.

Trade Credit is a loan advanced by a supplier of goods or services to its customers in the form of deferred and/or discounted payments. See, Credit Terms.

Useful Life is the period of time over which an asset maintains its value. For tax purposes, an asset may be depreciated over its useful life. For example, the useful life of a vehicle may be two years. See, Depreciation.

Variable Costs are those costs of providing a service that change with the amount of the service provided. For niche transportation companies, variable costs typically include drivers' salaries, gas, vehicle insurance, and a percentage of administrative costs. See, Fixed Costs.

Variable Rate Loans are loans in which the interest rate paid by the borrower may periodically change. Ordinarily, these changes are tied to a specified base rate such as the interest rate on Treasury bonds. See, Fixed Rate Loans.

Venture and Seed Capital Funds are private companies, frequently partnerships, that invest equity and long-term debt in new and expanding companies. See, Start-Up Capital, Expansion Capital, Informal Investors, and SBICs and MESBICs.

What If Analysis is used in making financial projections to determine how different changes in external factors and company strategy may impact upon financial performance. What if analysis helps a company adjust its projections to reflect best case, worst case and most likely case assumptions.

Working Capital equals current assets minus current liabilities. Working capital is used to finance a company's cash conversion cycle. See, Permanent Working Capital.

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